A REVIEW OF A.I.D.'s EXPERIENCE IN PRIVATE SECTOR DEVELOPMENT

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by

Jennifer Bremer

Elizabeth Cole

William Irelan

Phillip Rourk

of
Robert R. Nathan Associates, Inc.
Consulting Economists
Washington, DC

Prepared for

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AID EVALUATION PUBLICATIONS

A complete list of reports issued in the AID evaluation publication series is included in the back of this document, together with information for ordering reports.

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FOREWORD

This study is one in a series undertaken by the Center for Development Information and Evaluation, Bureau for Program and Policy Coordination, to examine Agency for International Development (AID) experience with the implementation of the Private Sector Development Initiative since 1981. It draws on the findings of the five studies listed below, as well as on special studies of the private sector in Costa Rica, Cameroon, Malawi, and the Dominican Republic. In addition, it synthesizes the policy lessons suggested in AID Policy Papers on the private sector, as well as a conference and related papers on private development held in 1982. This report also benefited from the draft President's Task Force Report on this subject and the working papers on which that report was based.

The other related papers in the series are as follows:

AID Evaluation Special Study No. 23 (PN-AAL-047), Private Sector Development in the Thai Seed Industry, Spring 1985

AID Evaluation Special Study No. 24 (PN-AAL-050), Management Education in Modern Tunisia, March 1985

AID Evaluation Special Study No. 25 (PN-AAL-051), Ecuador Industrial Development Finance, Spring 1985

AID Evaluation Special Study No. 26 (PN-AAL-052), Promoting the Manufacture and Use of Small-Scale Agricultural Machinery in Indonesia, Spring 1985

AID Evaluation Special Study No. 29 (PN-AAL-054), Private Development Corporation of the Philippines, Spring 1985

We are indebted to the authors of these papers for their contributions to AID's understanding of the role of the private sector in development and of the Agency's role in that development.

W. Haven North
Associate Assistant Administrator
Center for Development Information
and Evaluation
Bureau for Program and Policy
Coordination
Agency for International Development

SUMMARY

This study, undertaken at the request of the Center for Development Information and Evaluation of the Agency for International Development's (AID) Bureau for Program and Policy Coordination, provides a synthesis of AID experience since 1981 in implementing the Private Sector Development Initiative. It is based on a wide variety of sources, both published and oral, within other donor agencies as well as within AID.

1. MAJOR FINDINGS

The following are some of the major findings of the review.

1. Renewed emphasis on private sector development is occurring broadly within the donor community based on the lessons of experience over the last 3 decades. The costs and inefficiencies that result from attempts to effect development through administrative means, fiat, and state enterprises can be reduced by supporting the development of competitive markets through which private enterprises can be founded and encouraged to grow. Policy reform in many less developed countries (LDCs) is central to the realization of the development potential of markets and private enterprises.

2. The content of AID's development assistance portfolio in the private sector, as defined in this report, remains small. Excluding the Economic Support Fund (ESF), funding has approximated $300 million annually for FY 1982 to FY1984, or about 17 percent of the total development assistance obligations over the period.

3. There are advantages, and a large, barely tapped potential for using private sector delivery systems in developing countries. In some cases, a legitimate public interest requires continued public sector involvement, whether as a direct provider or as a regulator mechanism. The nature and degree of necessary public sector involvement even in these cases, however, is an issue that needs to be addressed through critical analysis and creativity.

4. AID's current institutional strengths suggest expansion of private programming in agricultural production and agricultural services, agroindustry, small- and medium-scale enterprise development, and housing and social services (especially training and education, health, and family planning).

Areas that are excessively demanding of specialized personnel resources or otherwise inconsistent with AID's comparative advantages include direct lending to individual LDC firms, direct equity investment in individual LDC firms, and support of U.S. private sector organizations, except as related to the

development needs of LDCs.

The most fundamental suggestion of the review is to continue to develop an approach that balances public and private initiatives appropriately, and to increase awareness of the possibilities for private sector development in all of AID's activities.

The design of the study is based on a concept of the private sector defined as "privately owned, for-profit firms engaged in the production for sale of goods and services." Among the entities and groups excluded by this definition are consumers; parastatals and government-owned or -controlled enterprise, whether operated for profit or not; individual and family-owned farms; and cooperatives, credit unions, private voluntary organizations, foundations, and other entities that are not operated for profit. This means that many other AID assistance programs (PL 480, ESF, sector grants, and loans) that affect enterprise in LDCs are not discussed. The advantage of this relatively restrictive definition of the private sector is that it highlights the set of problems and concerns most central to the formal Private Sector Initiative.

2. CHANGES SUGGESTED IN AID PRACTICE

1. Short-term, in-house training courses such as recently initiated by the AID Bureau for Private Enterprise (PRE) should be developed into a regular program, able to provide an initial grounding to a majority of AID professionals within a reasonable period of time, perhaps about 2 years.

2. Highly specialized personnel resources with skills in areas such as finance and international marketing should be concentrated within PRE where they may fulfill an essential, centralized support function for Mission activities. Additional recruitment of such specialized personnel is appropriate.

3. More resources should be devoted to policy analysis, training, and host country institutional development in support of policy dialogue and reform in developing countries.

4. Greater use of program lending appears to be necessary to support the implementation of major reforms, related institutional change, and the transitional costs of reforms during the period of adjustment.

5. AID should encourage LDC governments to make greater use of private sector organizations to implement their programs, and should itself demonstrate a greater willingness to assume some of the risks involved in doing so. Specifically, alternatives to host government guaranty of AID funds channeled through private sector organizations need to be developed.

6. Considerably more effort needs to be devoted to developing

programs that actively involve U.S. private sector resources in the development process. A priority focus is the attraction of U.S. investment capital.

7. AID programming should be guided by the principle of comparative advantage, which argues that the key question is not whether an organization can perform a function, but which functions it can perform best. This principle suggests that AID is particularly well suited for promotion of direct investment in ventures originating within the LDC itself; development of small-and medium-scale enterprises (particularly rural, agriculture-related, or agribusinesses, and institutions that support development in these areas); and support to policy reform directed toward encouraging private sector growth that is rapid, more broadly based, and more effective in meeting development goals.

8. To develop a private sector program integrated into the maintenance of AID assistance programming, AID needs to develop its capabilities in several technical areas related to the private sector. Five priority areas are (1) investment promotion; (2)\establishing a development center to provide assistance to Missions planning credit activities; (3) programs in the areas of equity market development, venture capital, and domestic resource mobilization; (4) more effective mobilization of U.S. private sector organizations; and (5) greater use of private sector delivery mechanisms in AID programs that traditionally have been implemented exclusively through the public sector, such as education and health.

9. The search for means of increasing leverage (in policy reform) deserves high priority. Three possible ways are closer cooperation with other donors in multilateral dialogue efforts, support to country efforts to develop a Structural Adjustment Program acceptable to the World Bank, and supplementing AID resources with those available through other U.S. agencies engaged in trade and overseas investment. (For example, the U.S. Government might offer trade concessions as part of an assistance package in support of policy reform.)

10. Greater attention to sound policy and sector analysis should be a prerequisite to AID assistance to any sector.

11. Loans to intermediate financial institutions (IFIs) should be supplemented by technical assistance to improve the costs and efficiency of these institutions (management information systems and training in project evaluation and monitoring are particularly appropriate).

12. In concentrating on its comparative advantages, the provision of local currency resources may be a potential market niche for AID because of the substantial amounts of local currency being generated by PL 480 and Commodity Import Programs (CIPs).

3. SUGGESTED STUDIES/EVALUATIONS THAT ARE RELEVANT TO AID's FORWARD AGENDA

1. A program of country specific Private Sector Constraint Analyses to identify and evaluate policy and nonpolicy constraints to the development of efficient markets and private enterprises should be initiated.

2. A study of policy dialogue could help to develop an understanding of policy dialogue as a process. The study should highlight experience with the use of leverage and conditionality and provide a comparative review of the use of program and sectoral (versus project) assistance in supporting policy reform. An analysis of the World Bank's structural adjustment lending program would be useful in this context.

3. There is an opportunity for AID to develop LDC-based, developed country-supported investment promotion as a major area of program activity. A detailed design study of the institutional alternatives for implementing such a program would be required prior to its initiation.

4. To provide policy guidelines and institutional alternatives for meeting the financial needs of specialized and low-income groups in LDCs on a commercial and self-sustaining basis, experiences with these commercial approaches should be brought together and systematically analyzed.

5. Commercial relationships appear to be the most prevalent vehicle for the spontaneous transfer of technology and the generation of joint investment ventures between developed and developing country partners. Case studies of this process could provide useful guidance on how AID might devote its resources to accelerating what appears to be a natural process, and on means which might be used to incorporate target groups in developing countries into trade-based systems for technology and investment capital transfer.

6. Experience with the process of achieving parastatal financial viability, or a transition to private sector management, needs to be brought together and analyzed to provide guidance to USAID Missions in providing assistance in this area.

7. Large firms can provide stable markets, technology, training, and credit to small- and medium-scale enterprises that are the target of AID assistance. A study of policy, legal, and regulatory measures that encourage or impede such relationships, as well as of ways in which AID and LDC governments can directly stimulate their coming into being, could help to uncover new methods of leveraging development assistance resources in support of private sector-based development.

GLOSSARY

AID - Agency for International Development

ANVAR - Agence Nationale de la Valorisation de la Recherche Nationale (French Agency for Commercial Application of Research)

ASEAN - Association of South East Asian Nations

ATI - Appropriate Technology International

BC - Business Cooperation

BDI - Bundesverband der Deutschen Industrie (Council of German Industry)

BESO - British Executive Service Overseas

BOP - balance of payments

CACM - Central American Common Market

CARICOM - Caribbean Common Market

CATCO - Commercial Agricultural Trading Company

CBI - Confederation of Industry

CCCE - Caisse Centrale de Cooperation Economique (Central Fund for Economic Cooperation -France)

CDC - Commonwealth Development Corporation (UK)

CDIE - Center for Development Information and Evaluation

CEPIA - Centre Francais de Promotion Industrielle en Afrique (French Centre for Industrial Promotion in Africa)

CESO - Canadian Executive Services Overseas

CFTC - Commonwealth Fund for Technical Cooperation (UK)

CIDA - Canadian International Development Agency

CIP - Commodity Import Program (Somalia)

CTTF - Canadian Technology Transfer Facility

DAC - Development Assistance Committee

DEG - Deutsche Entwicklungsgesellschaft (German Finance Corporation for Investments in Developing Countries)

DFC - development finance company

DIF - Direct Investment Fund

ECOWAS - Economic Organization of West African States

EEC - European Economic Community

EMD - Export Market Development program

ESF - Economic Support Fund

Eximbank - Export-Import Bank of the United States

GEMAH - Honduran Manager's Association Project

GTZ - Deutsche Gesellschaft f/r Technische Zusammenarbeit (German Agency for Technical Cooperation)

IBRD - International Bank for Reconstruction and Development (World Bank)

IDA - International Development Association

IDU - Industrial Development Unit (CFTC)

IESC - International Executive Service Corps

IFC - International Finance Corporation

IFI - intermediate financial institution

IMF - International Monetary Fund

INC - Industrial Cooperation Program (Canada)

IRRI - international rice research institution

ITC - International Trade Center (UN)

JACC - Joint Agricultural Consultative Corporation

KFW - Kreditanstalt f/r Wiederaufban (Reconstruction Credit Bank)

KOTRA - Korean Trade Promotion Office

LAAD - Latin American Agribusiness Development Corporation

LDC - less developed country

MIGA - Multilateral Investment Guarantee Agency

ODA - Overseas Development Administration (UK) or official development assistance

OECD - Organization for Economic Cooperation and Development

OPIC - Overseas Private Investment Corporation

PDCP - Private Development Corporation of the Philippines

PfP - Partnership for Productivity

PRE - AID Bureau for Private Enterprise

PROPARCO - Societe de Promotion et de Participation pour la Cooperation Economique (Agency for Promotion and Participation in Economic Cooperation - France)

PVO - private voluntary organization

SAL - Structural Adjustment Loan

SAP - Structural Adjustment Program

SME - small- and medium-scale enterprise

SSE - small-scale enterprise

TDP - Trade and Development Program (U.S.)

TFF - Trade Financing Facility

UN - United Nations

UNDP - United Nations Development Programme

UNIDO - United Nations Industrial Development Organization

USIPO - U.S. International Promotion Office

1. STUDY PURPOSE AND METHODOLOGY

1.1 Introduction

More than simply a new assistance program, the Agency for International Development (AID) Private Sector Initiative reflects and represents a broadly based reaffirmation of the role of markets and of private enterprise in economic development.

Western thought has always recognized the role of markets and of firms in the economic lives of nations. The so-called "developed economies" achieved that status during the last 150 years in large measure through reliance on these mechanisms to direct the processes of investment, production, and distribution which underlie their growth and social evolution.

In the early postwar period, when "development" first became a focus of systematic thought and organized activity, development assistance (as practiced by AID predecessor agencies and other early participants such as the World Bank) was basically premised on the view that the private sectors of the developing countries would quickly and effectively respond to opportunities, and generate rapid economic growth, if only supplied with a few missing key ingredients. Those ingredients were identified as basic infrastructure such as roads, power, and ports; investment capital; and "modern" or "advanced" technology and training in its use. The notion was that industrialization was the key, and that, given the requisite external support in the key areas cited above, private enterprise in the developing countries would achieve it.

Some successes were achieved, but the overall record of that period (roughly the decade of the l960s) was only mixed at best. In many countries, the anticipated private sector response was sluggish or nonexistent. In others, growth and a degree of industrialization were achieved, but not "development" in the full intended sense of that word. Large segments of developing countries' populations were left untouched or, in some extreme cases, were impoverished in the course of the dualistic growth which took place. Even in those sectors experiencing growth, that growth was recognized often to be largely artificial -- having few linkages to the rest of the domestic economy and characterized by factor proportions which were inconsistent with less developed country (LDC) factor and resource endowments and their comparative advantages.

Very broadly, the experiences of the 1950s and 1960s called into question the wisdom of relying too much on the private sector and market forces to achieve the equitable growth which was being pursued. Partly it was a question of frustration over the results of earlier efforts: market imperfections were perceived as too severe and private entrepreneurs as too rapacious or inept. Partly also, it may have been a consequence of growing nationalism in many LDCs, frequently expressed by open hostility to western multinational companies and by the rhetoric of exploitation. For whatever reasons, it came to be thought that accelerated development would require that the public sector intervene -- closely regulating the activities of the private sector in the public interest, and directly supplanting the private sector in those areas considered vital to development. Donors perceived the need to sharply focus the targeting of their assistance -- most easily accomplished through government-controlled delivery mechanisms -- and to support the public sector in its attempt to directly implement high priority development projects.

In a sense, the strategy can be described as an attempt to bypass, rather than directly confront, the market imperfections and LDC private sector limitations and constraints which had been encountered. Governments and donors during the 1970s sought to move quickly to a more advanced stage of development through direct action and direct controls to a much greater extent than in the previous period.

Following a decade or more of experience with a government-directed development philosophy, the limitations of that approach are now also becoming apparent. Where sufficiently rapid growth had failed to occur before -- in South Asia and much of Africa, for example -- growth still remains weak and uncertain. Industrial structures have remained artificial, still unsuited to local factor and resource endowments though closely regulated or directly controlled by governments. Agriculture has continued to lag. And, virtually everywhere, the magnitude of financial and human resources absorbed by governments has approached or begun to exceed the limits of sustainability.

Equity gains and the alleviation of absolute poverty have, with few exceptions, been meager in comparison both with objective needs and with the development goals which were enunciated.

As reported in this study, many of the major donor organizations have expressed the need to rethink the development strategy of the 1970s and their role in it, seeking specifically to find ways to restore an effective balance between reliance on the public and the private sectors in bringing about the changes and the growth needed to achieve development objectives. It has become apparent that the relative neglect of markets and of private enterprise which took place during the 1970s -- a consequence of the "bypass strategy" for accelerated development and its reliance on direct controls -- was a costly missed opportunity.

As reflected not only by the AID Private Sector Initiative but also by recent initiatives of the World Bank and the International Monetary Fund (IMF), and by the concerns of other donors, it appears that the time has come to step back from this strategy and to begin to directly address the constraints and limitations which have restricted and continue to restrict the performance of the private sectors of many LDCs -- during the 1960s as today.

Sustained growth is a necessary condition for development, and it has been understood that the private sectors of LDCs must assume a substantial, even the principal, burden of bringing that growth about. Also, it has been understood, through the experiences of a few countries which have been successful during the postwar period, that rapid and sustained growth can be broadly based -- providing incomes, employment, and the alleviation of poverty, which remain the central objectives of development assistance. The question is, how can the donor agencies most effectively contribute to the process -- once abandoned in frustration -- of stimulating the growth of markets, of market systems, and of private enterprises to achieve the goal of broadly based and equitable development?

It is within this context of evolving thought and creativity in the design of new approaches to development assistance that this study has been undertaken. While it focuses on recent AID experience, a considerably broader scope has been necessary to provide a basis for interpreting that experience. To provide perspective, some of the early experiences of AID during the 1950s and 1960s have been reviewed. The directions and content of AID's current private sector programs have been described, insofar as is possible with a rapidly evolving set of activities. Evaluations of individual projects implemented under the AID Private Sector Initiative have been assembled, and the frank and interested observations of other donor and other agency officials regarding their own and AID's efforts in private sector development have been assimilated.

The remainder of this section briefly describes the background, purpose, scope, data sources, and methodology of the study. It also presents the working definitions of the private sector and of private sector development used for the report, definitions which were necessary to delimit the subject matter and which provide guidance for the interpretation of our results.

Section 2 describes the AID Private Sector Initiative in terms of its rationale, its historical development, policy objectives and emphasis, the strategy adopted for its implementation, and program content during the fiscal 1981-1984 period.

Sections 3 and 4 are the central portions of the report in that they are intended to identify some of the distinct features and requirements of private sector-based development, describe major parameters that have shaped AID's programs, and present some of the lessons which appear to flow from both AID and other donor experience with key issues and major programming areas in private sector development.

Section 5 concludes the main body of the report with a compilation of lessons learned, some discussion of their implications for future AID programming, and suggestions of potentially fruitful areas for further analysis.

1.2 Antecedents to the Study

This review of the AID Private Sector Initiative builds upon a considerable body of research and documentation which has been generated within AID since early in 1982. The task has fortunately consisted not so much in breaking new ground as in assembling and attempting to synthesize the analyses, views, and observations of the large number of participants who have contributed to the process of defining, developing, and implementing the AID initiative.

Four major analytic efforts reflect the evolution of the AID Private Sector Initiative and AID's attempts to capture the lessons of its initial experience. The first of these was the early effort to define policy. It is reflected officially in two AID Policy Papers on the private sector, both issued in May 1982 -- one by the Bureau for Program and Policy Coordination (PPC) to provide guidance Agencywide, and one by the then newly created Bureau for Private Enterprise (PRE) to define its own mission within the context of the new Agency program. Also, a conference on Private Sector Development in LDCs was held during October 1982 to bring together people from the central bureaus of AID, USAID Mission staff, and outside participants to discuss the new policy and its implementation. The proceedings of this conference shed considerable light on the views of AID policymakers on the objectives of the Private Sector Initiative and on its intended relationship to ongoing Agency programs. During this period, PPC's Office of Evaluation made an additional contribution to the process of policy definition and the development of appropriate implementation strategies through the preparation of discussion papers summarizing selected aspects of previous AID experience in the private sector, and attempting to clarify basic issues and concepts.{1}

Subsequently, PPC's Office of Evaluation (currently organized as the Center for Development Information and Evaluation, CDIE) undertook two series of special studies designed to bring together additional information and experience pertinent to the ongoing development of the Private Sector Initiative. The first was a series of country studies aimed at documenting the variety of shapes and forms displayed by private sectors around the world, and at highlighting the role of government policies in conditioning the development of their private sectors. The private sectors and public policies of Costa Rica, Cameroon, Malawi, and the Dominican Republic were each the subject of a special study, summarized in a Program Evaluation Discussion Paper entitled A Comparative Analysis of Policies and Other Factors Which Affect the Role of the Private Sector in Economic Development.

A second series of special studies was undertaken to evaluate the historical experience of AID with projects dealing with different segments of the private sector. Five such studies have been prepared, dealing with the seed industry of Thailand, management education in Tunisia, a private development corporation in the Philippines, two industrial development finance companies (one public, one private) in Ecuador, and small-scale agricultural machinery manufacture in Indonesia. This series of studies was prepared during late 1983 and 1984.

A fourth major effort to further refine and develop AID private sector programs is currently underway. It consists of the work of the President's Task Force on International Private Enterprise and in the work of AID in preparing a new Policy Paper on Private Enterprise Development. This study has greatly benefited from having been provided access to draft copies of the new Policy Paper, the President's Task Force Report, and numerous working papers prepared for the Task Force.

{1}See especially Private Sector: Ideas and Opportunities -- A Review of Basic Concepts and Selected Experience, AID Program Evaluation Discussion Paper No. 14 (Washington, DC: AID, June

1982); and The Private Sector, the Public Sector, and Donor Assistance in Economic Development: An Interpretive Essay, AID Program Evaluation Discussion Paper No. 16 (Washington, DC: AID, March 1983).

1.3 Purpose and Scope of the Study

The purpose of this study is to attempt to synthesize AID and other donor experience with private sector development efforts, with emphasis on the recent experience from the 1981-1984 period. This synthesis is intended to highlight policy issues as well as to summarize lessons from the past that may serve as guidelines for future project designers.

Given the breadth and dynamic nature of the subject matter, the study makes no pretense of being definitive. Rather, it is intended to be more in the nature of a snapshot, describing the state of the action at the current time and attempting, on the basis of a backward look and the current picture, to identify issues and define alternative directions which that action might take in the future. The study is intended to contribute to thoughtful programming for the private sector rather than to advocate a particular approach to private sector development.

1.4 Data Sources and Methodology

As indicated above, the review has been conducted on the basis of secondary source materials and the interview of representatives of AID and other donor institutions. The study was conducted by a four-person team, expending about 7 person-months of effort over about a 3-month period.

1.4.1 Data Sources

In addition to the Policy Papers, Task Force reports, and special studies mentioned above, about 35 recent project evaluations of AID private sector projects were identified and reviewed. These and other documentation used for the study are listed in the Bibliographical Guide at the end of this report.

A data base of private sector projects obligated since FY\1981 was constructed based on information in the CDIE/Development Information unit's data base, supplemented by contacts with AID bureaus. A total of 158 active or completed projects were identified, as well as 38 projects still classified as "planned" as of this writing, totaling over $2 billion. To the extent possible on the basis of readily available information, these projects have been classified by country, region, or bureau; non-AID funding sources where applicable; type of assistance; main sector of involvement; target group; and project delivery system. Though extensive, this list is no doubt still incomplete. Some private sector projects have been missed, and others which have been included may have only minor private sector content. On balance, however, the data base provides sufficient information for the review of private sector program content presented in Section 2.

Field visits to the headquarters of other donor agencies were an invaluable source of information and informed commentary. In Washington, team members met with representatives of the IBRD, IFC, OPIC, Eximbank, TDP, and the President's Task Force on International Private Enterprise. The team also met with representatives of CIDA; the UNDP and UNIDO; the British ODA and CDC; the CFTC; the French Caisse Centrale, CEPIA, ANVAR, and Ministry of Economic Cooperation; the West German GTZ, DEG, BDI, BMZ, and KFW; and OECD officials in their respective home offices.

1.4.2 Definitions of the Private Sector and of Private Sector Development

The phrase "private sector development" conveys two distinct concepts: one, a type of, or approach to, development; and, two, a group -- the private sector -- which is the focus of that development. In determining which activities were appropriate to the subject matter of the study, it was necessary to adopt working definitions of these concepts which, while necessarily arbitrary to some degree, could provide an operational basis for delimiting the scope of the study while capturing the intent of the new development initiative.

Definition of the Private Sector

A variety of definitions could be formulated to specify what is meant by the "private sector." This study uses a relatively restrictive definition to highlight the set of problems and concerns most central to private sector development. The study therefore defines the private sector as follows:

> The set of privately owned, for-profit firms engaged in the production for sale of goods or services.

As used in this study, the definition excludes a variety of economic entities or groups that could be included in broader definitions of the private sector used for other purposes. Examples of the entities and groups that we have excluded include the following:

- Consumers

- Parastatals and government-owned or controlled enterprises, whether operated for profit or not

- Cooperatives, credit unions, private voluntary organizations, foundations, and other entities that are not operated for profit

Although farms technically still fit the restricted definition, individual- and family-owned farms are excluded in order to tighten the focus of the study. Since agriculture is primarily in private hands throughout the developing world, all programs designed to promote agricultural development could be viewed as private sector programs, including agricultural research and extension, land reform, and so on. Such programs are clearly outside the scope of what is meant by "private sector development," however, and therefore the farm sector is generally excluded from the definition used in this study. Corporate farms and businesses producing farm inputs (e.g., fertilizers) or processing agricultural products (e.g., dairies and canneries) are, however, included.

Definition of Private Sector Development

The term "private sector development" is used to refer to two separate concepts:

1. Development of the private sector economy -- private enterprises operating within a market system -- as a means of achieving broader development goals such as equity, efficiency, growth, and employment

2. Use of private sector entities as a tool for accomplishing other development purposes that are basically unrelated to the private sector economy

These two concepts, while very different, are nonetheless difficult to separate in practice because approaches relying on private sector entities as vehicles for delivering development services often incorporate efforts to strengthen these institutions themselves. Similarly, the mere fact of expanding private sector activities does not ensure consistency with broader social goals such as equity and employment creation. Growth of the private sector is a necessary but not sufficient condition for achieving private sector development.

To clarify the second concept, consider a program to deliver primary education services in poor rural areas. Which of the following should be considered private sector development?

1. A loan program in a private bank to finance small private schools operated by the owners of rural industries

2. A program to assist the Ministry of Education to support such schools

3. A program to transfer inexpensive school-building technologies to private sector contractors used by the Ministry to construct public schools

4. A program of public school construction that uses private

contractors but provides them no other assistance

The first program is clearly private sector development -- it uses a private institution to foster the development of another profit-making institution. The fourth program, however, implies a definition of private sector development so broad that almost all projects would qualify and is clearly not operational.

The two programs in between are more difficult to classify. Number 3 provides assistance to a public entity through private entities, while also assisting the latter; number 2 provides assistance to private entities, but entirely through a public entity. For purposes of this study, both of these programs will be included in the definition of private sector development. Nonetheless, projects of the second and third type will only be classified as private sector development programs if such development is a major and intended element of the program, rather than an incidental effect. This distinction is not always clearly drawn in project documentation, but an attempt has been made to apply it as strictly as possible.

The definition of private sector development is further complicated by the close involvement of the public sector in determining the climate for private sector expansion. In many situations, it may be necessary, for example, to work with the public sector to improve the climate for private investment. In this study, such programs are included in the definition of private sector development, whether they involve direct contact with or participation by the private sector. Examples of such activities include:

-- AID's policy dialogue and policy analysis activities

-- Programs to develop the capacity of public sector institutions (such as management training and development banks) to serve the needs of the private sector

-- Programs to promote private sector investment, including those that work through public sector or offshore entities

2. OVERVIEW OF THE AID PRIVATE SECTOR INITIATIVE

2.1 The Development Rationale for the Private Sector Initiative

The renewed emphasis on private sector approaches to development is the outgrowth of the collective reexamination of the development record of over three decades of experience by a significant body of development professionals. That reexamination has revealed that excessive reliance on public sector activism and direct controls has led to generally disappointing results, and that, conversely, market-oriented economic systems, when provided with an appropriate environment by the public sector, have yielded remarkable successes not only in achieving growth, but also in advancing the broader objectives of development.

The World Bank's World_Development Report 1983 -- an issue devoted to the special topic of Management in Development -- provides useful insight into the thinking of another major donor organization. A selection of brief quotations from that report indicates the tenor of that thought:

> In an effort to accelerate development, governments have become increasingly active. In the process many have often been badly overextended and hence have contributed to inefficiency....
>
> The role of the public sector has to be tailored to the human and financial resources available, and these are almost everywhere overstretched. Hence the importance of relying on markets to do what experience has shown that markets generally do best. That still leaves the government responsible for macroeconomic policy, for managing public revenues and expenditures, and for running public enterprises and public services. Equipping the public service to carry out these tasks well is challenge enough. [from "Concluding Themes"]
>
> The key factor determining the efficiency of an enterprise is not whether it is publicly or privately owned, but how it is managed. In theory it is possible to create the kind of incentives that will maximize efficiency under any type of ownership. But there is a great difference between what is theoretically feasible and what typically happens.
>
> ...the greater potential for competition and the ever-present possibility of bankruptcy exercises a discipline over private businesses that is lacking in the public sector.... Recognizing that, some governments have decided to reduce the size of the public sector, while others are actively considering doing so. This choice has nothing to do with political ideology.
>
> ..today's widespread reexamination of the role of the state is evidence of a new realism. In the search for greater cost-effectiveness in the provision of services, governments are exploring ways of tapping private initiative and stimulating competitive conditions. [from "The Role of the State"]
>
> Price distortions may be caused by monopolistic tendencies in the private sector or

by government intervention.... In most instances, however, price distortions are introduced by government directly or indirectly in pursuit of some social or economic objective....

...price distortions are found to be inversely related to growth and efficiency, but there is not strong evidence of such distortions leading to any gain in equity. [from "Pricing for Efficiency"]

Elsewhere, the report suggests that "many countries could improve their economic performance if governments intervened less in markets," and that examples of alternatives to government action might include "'pump-priming' of private sector activity -- and of increased competition -- through the provision of credit"; "the provision of extension advice by private traders in agriculture and village midwives in health, and the substitution of private tubewells for lumpy government investment in dams." Other examples of private sector approaches to development are presented in the Bank report for a range of sectors.

In his annual report to the UNDP Governing Council, the Administrator of UNDP recently identified the need "for stronger institutional arrangements to tap the enormous technical capacity of the private sector for the benefit of developing countries." Further, he notes that

...other possibilities to involve private industry ...have usually not been exploited because most technical cooperation programmes have been oriented toward the public sector.... Ways are needed to enable the private sector, where governments wish, to participate in programme planning and in project formulation.... Also, direct technical support could be increased to specific groups including, in particular, artisans, entrepreneurs, and small-scale firms.... In many cases, industry associations and cooperatives would be the proper channels.{2}

The foregoing passages and similar recent statements of representatives of the British, German, and Canadian donor agencies exemplify a growing awareness on the part of donors and governments alike of the need to redirect development assistance efforts in a manner which more fully and directly incorporates LDC and developed country private sectors in the development process. AID, through its Private Sector Initiative, is in the forefront, but by no means alone, in responding to this widely perceived development priority.

While excessive government intervention in investment, production, and distribution functions has been recognized to be deleterious, this is far from implying that private sector development embraces an uncritical return to laissez-faire policies. The development lessons of the 1950s and early 1960s, and the success stories of the next two decades point to a vital role for the public sector in providing the policy environment, legal framework, and requisite public services that are indispensable preconditions for the salutary development of private sector activity. Continued donor assistance to governments to enable the improvement of their performance of these essential roles is an integral part of effective private sector development approaches.

Countries whose development experiences during the 1960s and 1970s offer lessons for private sector approaches to development -- a list which varies somewhat from observer to observer, but which generally includes countries such as Korea, Taiwan, Singapore, and Thailand in Asia; Malawi, Kenya, Cameroon, Ivory Coast, and Tunisia in Africa; and Brazil, Costa Rica, and Colombia in Latin America -- to a substantial degree also share the following common characteristics derived from the performance of their public sectors:

-- A high degree of policy reliance on market systems and the private ownership of enterprises.

-- Fiscal, monetary, exchange rate, wage, and trade polices that have been relatively neutral between agriculture and industry, between serving domestic and export markets, between labor and capital intensity, and between large- and small-scale industry. Such policy neutrality has avoided many of the price distortions that have elsewhere resulted in severe resource misallocations, efficiency losses, and reduced growth.

-- Substantial "openness" to international trade and foreign investment, a consequence of the policy stance described above.

-- Widespread competition and ease-of-entry in factor, input, and product markets -- in part due to the "openness" of their economies to trade and foreign investment.

-- Relatively efficient, honest, and cost-effective public administration.

Recent empirical studies unequivocally point to the importance of domestic policies in determining growth performance, and to the dependence of development assistance, for its effectiveness, on the presence of a domestic policy environment that is hospitable and conducive to growth.{3} Table 1, adapted from the World Bank's World Development Report 1983, is dramatic evidence of the estimated costs of policy-induced price distortions. This table contrasts performance indicators for 31 countries according to the severity of prevailing price distortions, based on data from the 1970s.

The evidence presented in Table 1, circumstantial though it may be, is persuasive in emphasizing the role of policies in either facilitating or retarding growth. The group of l2 countries with a high degree of policy-induced price distortion has, on average, grown almost 4 percent less rapidly per year than those where market prices have been allowed to reflect economic opportunity costs. The experience of the former shows sharply reduced domestic savings rates (a result of artificially low interest rates), relatively high capital to output ratios (due to implicit subsidies on capital and distorted wages), poor agricultural performance (often related to price controls and other forms of resource transfer out of rural production), and slow growth in exports and manufactures.

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Table 1. Price Distortions[a] and Economic Growth Performances During the 1970s (percentages)

Growth Performance Category	Low-Distortion Countries[b]	High-Distortion Countries[c]	Difference
Average Annual GNP Growth Rate	6.8	3.1	-3.7
Average Domestic Savings Income Ratio	21.4	13.8	-7.6
Average Additional Output per Unit of Investment	27.6	16.8	-10.8
Average Annual Growth Rate of Agriculture	4.4	1.8	-2.6
Average Annual Growth Rate of Industry	9.1	3.2	-5.9
Average Annual Growth of Export Volume	6.7	0.7	-6.0

[a] An index of pricing distortions induced through the foreign exchange rate, protection of manufacturing, protection or taxation of agriculture, capital pricing, labor pricing, power tariffs, and inflation.
[b] Includes Malawi, Thailand, Cameroon, Korea, Malaysia, Philippines, Tunisia, Kenya, Yugoslavia, and Colombia.
[c] Includes Senegal, Pakistan, Jamaica, Uruguay, Bolivia, Peru,

Argentina, Chile, Tanzania, Bangladesh, Nigeria, and Ghana.

Source: IBRD, World Development Report 1983, Table 6.1.

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Assistance to governments in achieving a more favorable policy environment and in improving their own performance in policy formulation, policy implementation, and in the delivery of essential public services is, as will be seen from the review of AID Policy Papers, a central thrust of the Private Sector Development Initiative. The proponents of this approach to development are quite explicit in their view that, unless fundamental policy reforms are undertaken, extremely scarce financial and technical assistance resources will, in many countries, be wasted regardless of whether they are directed at the private or the public sectors of those countries.

At the same time, recent policy statements are explicit in their recognition that policy reform is not easy. Governments will require assistance both in the analysis of alternative approaches to policy reform in specific country situations, and in bearing the transitional costs which invariably accompany structural adjustments to new "rules of the game." The importance of such assistance has been emphasized in AID's Private Sector Initiative as well as in the World Bank's structural adjustment lending program.

A third and equally important element in the economic rationale for the Private Sector Initiative consists in the recognition of the extremely limited magnitude of available official development assistance (ODA) resources in relation to LDC requirements and in relation to the potential contribution of developed-country private sectors. For example, the President's Task Force on International Private Enterprise states in its draft report that

> Foreign assistance can be expected to have only limited impact as a resource transfer mechanism, given the size of developing country economies and the problems they face because of debt burdens, the global recession and internal economic difficulties.... On a global basis foreign assistance disbursements of all OECD members would cover interest on LDC debt for less than six months.

Table 2 provides an estimate of 1981 resource flows to non-oil-exporting developing countries from the industrial market economies and OPEC members.

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Table 2. Resource Flows to Non-Oil-Exporting LDCs From the Industrial Market Economies and OPEC Members, 1981 (billions of U.S. dollars)

Type of Resource Flow		Amount
Official Development Assistance [a]		36.6
Grants by Private Voluntary Agencies [a]		2.0
Nonconcessional Flows [a]		69.3
Private Credits	42.3	
Private Direct Investment	16.1	
Other	10.9	
LDC Merchandise Exports (excluding petroleum) to Industrial Market Economies and High-Income Oil Exporters [b]		143.2

Total		251.1

[a] Source: The President's Task Force on International Private Enterprise, Draft Report, September 14, 1984.

[b] Source: IBRD, World Development Report 1983, Statistical Annex.

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As shown in Table 2, by far the most important source of foreign exchange flowing to the developing economies ($143 billion in 1981) is their earnings on merchandise exports to industrialized nations. This source, complemented by LDC exports to other LDCs -- an additional $77 billion in 1981 -- also has the greatest potential for sustained future expansion.

Private credits, direct investments, and grants added another $60 billion to LDC resources in 1981, followed by official development assistance (ODA) at about $37 billion. Historically, private flows have consistently exceeded official assistance by far.

Budgetary restraints in the developed countries will place limits on the growth rate of ODA. The existing debt service obligations of many LDCs limit their ability to absorb increased volumes of credit, even if it were available. The need to mobilize additional developed country private sector resources in support of development -- especially through increased trade and increased investment -- is therefore apparent and a central component of private sector development approaches.

{2}Policy Review: Measures To Be Taken To Meet the Changing Technical Cooperation Requirements of the Developing Countries, Report of the Administrator to the Governing Council of the UNDP, April 2, 1984, p. 30.

{3}See IBRD, World Development Report 1983, Ch. 6, "Pricing for Efficiency, A Statistical Analysis of Pricing Distortions and Growth;" Keith Marsden, "Foreign Aid, the Private Sector and Economic Growth," paper prepared for the President's Task Force on International Private Enterprise, March 1984; and Keith Marsden, Links Between Taxes and Economic Growth: Some Empirical Evidence, World Bank Staff Working Paper No. 605, August 1983.

2.2 Historical Development Within AID

A recent report prepared for the President's Task Force, identifies four major periods of U.S. foreign assistance, distinguishable by major changes in program orientation:{4}

- -- 1945-1957, reconstruction assistance to Western Europe under the Marshall Plan
- -- 1957-1973, shift to the LDCs, with major emphasis on infrastructure and industrial projects under the Development Loan Fund and subsequent AID programs
- -- 1973-1980, the "New Directions" period, with emphasis on basic human needs and the direct provision of services to the poorest rural and urban groups, with limited assistance to the indigenous private sectors
- -- 1980-present, renewed emphasis on private sector development approaches as potentially more effective means of achieving equitable growth

The following section, which deals primarily with the 1957-1973 period, draws heavily on the comprehensive historical review prepared for the President's Task Force.

{4}Deborah M. Orsini, "AID Private Sector Initiatives: Past, Present and Lessons Learned," prepared for the President's Task Force on International Private Enterprise, November 1983

2.2.1 Early AID Experience in the Private Sector

Some elements of private sector development approaches have been continually present in AID programming. Many of these were first implemented during the period from 1957 to 1973, making this period particularly relevant for current study. Selected private sector projects initiated during that time have been the subject of in-depth review through a series of PPC Special Studies aimed at collecting specific lessons which may serve to orient current programming. These studies are summarized in Appendix B and lessons learned from them are incorporated throughout this report.

Program elements which are currently being implemented or being considered for implementation under the Private Sector Initiative can be related to similar projects and programs of the 1957-1973 period. The latter can be classified into the following 10 areas:

1. Industrial development
2. Foreign exchange access and savings
3. Policy dialogue
4. Capital market development
5. Private investment promotion
6. Export promotion
7. Tourism
8. Training
9. Technology transfer
10. Small-scale enterprise development

Industrial Development

The Development Loan Fund (DLF), created in 1957 and merged in 1961 with the International Cooperation Agency to form AID, is an interesting example of early efforts at assisting the LDC private sectors. About 34 percent of the resources committed by the DLF ($716 million out of $2.1 billion) were directed to the private sector -- about a third in direct loans to enterprises, a third channeled through intermediate credit institutions serving the private sector, and a third in lending to the public sector for projects with private sector impact. Of the DLF portfolio loaned to the public sector, most was directed at major infrastructure projects.

DLF operated its lending program on a revolving fund basis, included convertible debentures among the debt instruments it accepted, and is said to have pioneered the use of intermediate credit institutions as on-lenders to small business.

Limitations of the DLF program include lack of experience among investors financed by the program (with insufficient loan monitoring by DLF administrators), problems with the degree of capitalization of DLF projects, and the extreme labor-intensity of direct-lending approaches.

Foreign Exchange Access and Policy Dialogue

Program loans, commodity import programs, and cash transfers have long been a vehicle of AID assistance in overcoming foreign exchange constraints in LDCs. The PL 480 program has also been used to enable LDCs to save foreign exchange. Until recently, however, only a small portion of these funds could be classified as private sector assistance.

Early AID experience with such programs is therefore primarily of interest with regard to their conditionality and use in the context of AID/host-government dialogue on policy reform.

A 1970 study of the use of program loans to influence public policy during the 1960s concludes that they were effective in influencing policy but that the results obtained from policy reforms were only moderately encouraging, excepting Korea where results were impressive.{5} Countries studied included Brazil, Chile, Colombia, India, Korea, Pakistan, Tunisia, and Turkey, several of which performed rather well in the l970s.

Issues such as the quality of policy advice given, the need for institutional mechanisms for implementing policy and the time needed for policy reforms to generate their impact -- issues now recognized as being crucial -- are not addressed by the 1970 study. It is therefore difficult to draw conclusions from this early study of AID experience.

Capital Market Development

AID has been active in supporting intermediate credit institutions since the early 1960s. It also had rather limited experience in efforts aimed at developing local securities markets during this period. By and large, AID's assistance to credit institutions has been successful in terms of the ability of such institutions to sustain themselves and grow, improve the financial and business practices of their borrowers, and in some instances, provide technical assistance to borrowers. Their growth has often depended on continued donor funding, however, rather than on effective domestic resource mobilization.

Problems which have frequently been identified include misallocation of credit resources channeled through intermediaries because of inappropriate government policies, inadequate coverage of the credit needs of small and medium enterprises, and excessive collateral requirements.

With respect to the development of capital markets, AID's early experience is very limited. The more recent experience of other donors, such as the IFC, is a better source of lessons which may be applicable to current AID efforts.

Foreign Private Investment Promotion

Beginning in the late l950s through the decade of the 1960s, AID was successfully engaged in investment promotion efforts through the Cooley loan program, investment guaranties, support of investment centers and groups, and assistance with project identification and feasibility studies. The Cooley program channeled local currency loans to U.S. firms, or their affiliates, for business development in LDCs. Loan funds were derived from local sales under PL 480. The equivalent of about $430 million was disbursed in 227 Cooley loans, which were judged to have been highly successful with good repayment performance. Loan recipients included joint ventures and the local affiliates of major U.S. firms, such as Ralston Purina, Goodyear, Gillette, Quaker Oats, Sears Roebuck, and others of that size and reputation.

AID investment guaranty programs which date from the early period include the Specific Risk Guaranty Program, the Extended Risk Guaranty Program, and the Housing Guaranty Program. During their life, the first two programs resulted in $2.6 billion in investment guaranties, while the Housing Program has over $1 billion in guaranties outstanding. AID's risk guaranty programs, later absorbed by OPIC, were considered to have had a substantial impact on the rate of U.S. direct investment in LDCs, though it is impossible to quantify the extent of additionality generated by the guaranties. New forms of investment guaranty are currently under consideration by both AID and the World Bank, as is discussed below.

AID supported the establishment of investment promotion centers in India, Korea, Taiwan, Thailand, and Indonesia. Investment promotion is an area in which AID and other donors are now becoming increasingly active, though through different mechanisms. Similarly, AID in the past supported project identification and preparation efforts aimed at encouraging U.S. private sector investments. One was the Investment Survey Program, in which AID reimbursed 50 percent of the costs of unsuccessful investor survey missions to LDCs. Also, the Bureau for Latin American and the Caribbean (LAC) financed a substantial feasibility studies program during the 1960s, which resulted in a large volume of investment. The latter program was criticized, however, in that feasibility studies were conducted prior to the identification of potentially interested investors, and many of the studies were never used. More recent AID project development assistance efforts seek to finance studies in response to an identified demand, potentially a more cost-effective approach than the previous inventory-building concept.

Export Promotion and Tourism

Through the 1960s and 1970s, AID financed a variety of projects aimed at increasing foreign exchange earnings through exports. Tourism projects in Asia, the Near East, Africa, and Central America were numerous during the 1960s, prior to the New

Directions mandate and its emphasis on direct assistance to the poor. Export promotion efforts developed to a greater extent during the 1970s with assistance in the establishment of industry groups, organization and finance of trade missions, contracting for market studies, and both technical and financial support for LDC export promotion organizations. Examples of AID involvement include assistance to the Korean Trade Promotion Office (KOTRA) and support of the World Trade Institute.

Training

AID has long supported both vocational and management training programs. Management training has been provided both in the United States and in-country. These programs have been judged to be successful to the extent that training efforts have been responsive to demand and based on carefully identified training needs, and to the extent that the organization of training institutions has provided for an eventual transition to a self-supporting basis through the contributions of trainees, the contributions of employers, and/or the sale of services to the community at large.

Technology Transfer

AID has promoted the transfer of technology to LDC enterprises through the support of joint ventures, assistance to technology-oriented PVOs and support of specialized organizations such as the Joint Agricultural Consultative Corp. (JACC) and the International Executive Service Corps (IESC).

Early AID activity in facilitating joint ventures as a means of technology transfer took place primarily under the Cooley loan program, briefly discussed above.

The IESC was organized in 1964 and has by now engaged in nearly 9,000 technology transfer projects involving management and other technical assistance, primarily to private enterprises, in over 30 countries. Other private voluntary organizations (PVOs), such as Technoserve, ACCION/AITEC, and Partnership for Productivity (PfP), have been active since the mid-1960s in providing a wide range of technical and managerial assistance services to small enterprises in the developing countries. More recently, organizations such as Appropriate Technology, Inc. (ATI) and others have been focusing, in addition to the pure transfer function, on the development or adaptation, and subsequent dissemination, of specialized technologies which are suited to the needs and conditions of small farmers and entrepreneurs. The use of PVOs has traditionally been targeted toward assisting small-scale enterprises (SSEs) and community organizations, to a large extent in rural areas. They continue to be an important element of AID private sector development efforts.

Small-Scale Enterprise Development

Between 1952 and 1980, over 775 SSE projects, mostly in Asia and Latin America and mostly initiated prior to 1973, were funded by AID. These projects sought to combine financial and technical assistance for small enterprises and were usually implemented through private voluntary organizations such as discussed above.

The integration of technical and financial assistance which is characteristic of these programs has been highlighted as the key factor in their success. The key challenges they have faced have consisted in providing sufficient quantities of technical assistance and in managing credit cost-effectively.

{5}Bureau for Program and Policy Coordination, Evaluation Staff, The Use of Program Loans to Influence Policy, AID Evaluation Paper 1A, (Washington, DC: AID, March 1970).

2.2.2 The New Directions Period -- 1974 to 1980

In response to sections 101 and 102 of the Foreign Assistance Act, AID undertook in this period to restructure its assistance program and to target the components of that program in a manner more directly and visibly benefiting the poorest segments of LDC populations. Emphasis was placed on increasing the incomes of the poor and increasing their access to public services so as to enable them to satisfy their basic needs of food, shelter, health, and education.

This congressional mandate did not directly imply a deemphasis of the private sector as a recipient of AID assistance, nor did AID's response to the mandate imply such an interpretation. Indeed, it could be argued that the focus on agriculture and rural development which emerged during this period -- a response to the fact that the majority of the poor in LDCs are rural residents who depend primarily on agriculture for their livelihoods -- was in fact a major expansion of private sector activity. Small farmers make up the largest part of the private sector in many LDCs. However, the need to directly target assistance to the poor resulted, first, in a greater reliance on public sector institutions as delivery mechanisms for AID assistance, and, second, in a relative deemphasis of projects and programs whose benefits for the poor were indirect, and hence difficult to quantify or demonstrate conclusively.

Examples of the program areas which had been important elements of AID assistance previously, and which have now been reincorporated in private sector development efforts -- but which were deemphasized during the New Directions period -- include the following:

-- Policy analysis, dialogue, and reform, especially at the macrolevel

-- Enterprise development, including SSEs and medium-scale enterprises in the manufacturing, commercial, and services sectors

-- Capital market development and support of other private sector institutions, including their use as delivery mechanisms for development assistance

-- Private investment promotion as a means of transfer of financial and technological resources to LDCs

An exposition of the development rationale for placing renewed emphasis on such programs under the Private Sector Initiative has been presented above. It is, simply stated, that approaches which emphasize the role of the private sector in development have been recognized to be important for sustaining growth and for the alleviation of poverty. The objectives of development have not changed with the Private Sector Initiative. What is changing is the approach.

Policy guidelines developed within AID, both through formal Policy Papers and through a continuing dialogue such as that which took place during the 1982 Conference on LDC Experience With Private Sector Development, provide a basis for describing this approach in more specific terms, and a framework for presenting a summary of private sector program content during the 1981-1984 period.

2.3 Private Sector Development Policy

Two policy statements on private enterprise development have been issued by AID since 1981, while a third is currently in draft.{6} The first provides Agencywide guidance on the objectives and desired content of projects and programs for implementing the Private Sector Initiative, while the second is specific to the Bureau for Private Enterprise, created in l982 to serve as a "laboratory for experimentation to test and try out new ideas that can then be replicated by the other operating bureaus of AID."{7}

The policy statements provide an initial discussion of the respective roles of the public and private sectors in development. They recognize the indispensable role of governments in certain areas of economic activity, but also provide an assessment of the economic costs of excessive dominance by the public over the private sector.

Examples of excessive interventions by certain governments include instances of inefficient direct production by the state in sectors such as marketing, finance, heavy industry, and utilities; appropriation of scarce capital and management resources which might otherwise be more efficiently used by the private sector; and a variety of policy interventions in the areas of pricing, trade, investment, and taxation which can distort the allocation of private investments, discourage savings, and reduce output by moving production away from the patterns indicated by comparative advantage.

The objective of private sector development is declared to be two-pronged, intended to promote both the development of individual enterprises and a viable competitive market environment within which they can efficiently operate. Recognition of the essential complementarity of these two objectives is important in that equitable development is only likely to be realized when both a market-oriented environment and viable private enterprises are present. Under such conditions private sector investments can meet developmental as well as business objectives, and the enhanced efficiency and accelerated growth resulting from decentralized private decisionmaking can indeed serve as the basis for meeting basic human needs.

{6}The AID Policy Papers are Private Enterprise Development, May 1982; Bureau for Private Enterprise Policy Paper, May 1982; and "Private Enterprise Development," (draft), July 1984.

{7}John R. Bolton, Assistant Administrator, Bureau for Program and Policy Coordination, AID, Conference on LDC Experience with Private Sector Development, Proceedings of the Opening Plenary Session, October 12, 1982.

2.4 New Programming Emphases

Four basic mechanisms for accomplishing the dual objectives of private enterprise development are identified in the Policy Papers and other relevant documentation. The first and perhaps most important is a commitment to engage LDC governments in an active dialogue regarding policy reform. Host government policies are identified as being "perhaps the most severe constraints to private enterprise."{8} In an effort to secure movement towards "consistent market-oriented pricing policies in product, factor, and financial markets," and "a legal and regulatory framework which protects private property, rewards risk taking, promotes competitive market structures, and enforces valid commercial transactions,"{9} USAID Missions are enjoined to identify and prioritize the modification of harmful policies through ongoing discussions with host governments. The preparation of high-quality policy analyses and contributing to the creation of capacity for ongoing policy analysis are viewed, along with the exercise of conditionality in project lending and coordination with other donors, as key instruments for implementing the policy dialogue.

Second, the Policy Papers urge USAID Missions to seek project opportunities to provide development assistance directly to LDC private enterprises. "In the most significant sense," states a recent PRE memorandum, "a private sector project is one in which the recipient or beneficiary of the AID funds is a private, for-profit, non-subsidized indigenous business enterprise."

Third, wherever possible, institutional intermediaries for delivering project assistance should also belong to the private sector. This preference encompasses projects providing assistance to private enterprises, and also projects in such fields as health care delivery which have in many LDCs been traditionally viewed as falling exclusively within the public sector domain.

In response to a question raised at the AID conference regarding the use of LDC parastatals, the AID Administrator was quite explicit: "Where there is a private sector option, then as far as I am concerned, we should be pursuing the private sector option.... Presented with such options, I think I will consistently make that decision...." During the same session, the Assistant AID Administrator for policy further clarified the intent of AID policymakers:

> The private enterprise initiative is a concept which should infuse every single thing we do. If you are concerned about the health care system in a particular country, serving the private sector initiative doesn't mean going out and subsidizing a pharmaceutical company. It says, how can we best use the private sector to deliver a wide range of health care? How can we use it in family planning, how can we use it in whatever area of focus your country has selected. ...[I]t is not simply a case of saying your project portfolio has to have one or two things called private sector projects. Everything in your project portfolio should be reflective of the initiative.

Finally, a fourth major policy emphasis is increasing the flow of technical and financial resources to the developing world through involving U.S. private enterprise. A variety of means for engaging U.S. private enterprises in technology transfer and project financing are identified, and USAID Missions are encouraged to seek out such opportunities. The Policy Papers also make clear that the AID goal in such activities is the development of the indigenous private sector. AID is not engaging, through the Private Sector Initiative, in activities whose primary purpose is improving the market for the U.S. private sector -- though this may be an appropriate role for other U.S. Government agencies, and it is recognized that legitimate occasions often arise in which U.S. and LDC private sector interests coincide. Such occasions provide opportunities for AID to cooperate with commercial interests, other donors, and other U.S. Government agencies in "packaging" services and resources destined to support developmental projects.

{8}AID Policy Paper, Private Enterprise Development, May 1982, p. 3.

{9}Ibid., pp. 6-7.

2.5 Implementation Strategy

As is apparent from the policy statements cited above, the Private Sector Initiative is an Agencywide effort. It is not intended as a new program within AID's portfolio, but as a new approach to development assistance, a new approach which is relevant to all of the program and sectoral components of the AID portfolio.

When the new initiative was undertaken, however, it was recognized that AID had little recent experience in private sector development, and relatively few specialized manpower resources familiar with private sector practices or some of the specific instruments needed to implement this new approach to development assistance. Utilization of private sector mechanisms to achieve development purposes was unlike previous efforts. Considerable learning would be involved in the process of developing the approach, identifying pitfalls, and assessing the potential of alternative interventions.

A three-pronged strategy was developed to enable AID to learn the necessary initial lessons, disseminate them, and establish the capability to implement them throughout the operating bureaus and overseas USAID Missions. The three major elements of that strategy were as follows:

1. The creation of a Bureau for Private Enterprise, where the specialized resources of AID could be assembled to develop, with a relatively small budget, project approaches that could be used to implement the Private Sector Initiative. As stated earlier, PRE was consciously viewed as a "laboratory" for experimentation with new approaches, the collation of experience with them, and the dissemination of viable approaches throughout AID.

2. The "set aside" program which consisted of funds made available for joint development of private sector projects by PRE and USAID Missions. The set aside program was a vehicle intended to support the rapid dissemination of private sector approaches among the field Missions.{10}

3. Recruitment and manpower development intended to provide USAID Missions and bureaus with the requisite technical skills for the full institutionalization and continuing implementation of the Private Sector Initiative.

Over fewer than 4 years, AID has made considerable progress in implementing the above strategy. The conceptual basis for the Private Sector Initiative is today much better understood than at the outset. Private sector development specialists are now in place in many of the USAID Missions and central regional bureaus. Most important, the number of private sector development projects funded by AID -- through PRE, the set-aside program, USAID Missions and bureaus -- continues to grow. Over 200 private sector projects obligated between fiscal year (FY) 1981 and FY 1984 have been identified in the course of this study.

Some definite directions have emerged in AID's private sector development efforts. Along with these, a number of issues have emerged, and the process of drawing lessons has begun. These will be reviewed in Section 3.

As essential background, this section concludes with a description of the FY 1981-1984 private sector development portfolio, based on a tally put together through the assistance of CDIE/Development Information (DI) office and the cooperation of AID central and regional bureaus.

{10}Originally conceived as temporary in nature, the set-aside program was discontinued during 1984 as simpler direct collaborative relationships between PRE and USAID Missions had sufficiently developed by that time, and had proved themselves less cumbersome than the set-aside mechanism.

2.6 Private Sector Program Content

To assess the progress of the Private Sector Initiative since 1981, the assistance of the CDIE/DI and central bureaus of AID was enlisted in an effort to identify projects and construct a small data base containing information on key characteristics. Appendix C contains a listing of the projects that have been identified to date.

This data base is not a complete enumeration of AID private sector projects. Because it is based on readily accessible information sources only, a number of projects that are still being processed for inclusion in AID's information systems may have been overlooked. Some of the projects included may be miscoded in terms of emphasis -- for example, inclusion or exclusion of a technology transfer component. For some projects, information on components and on delivery mechanisms is lacking altogether. Some projects combine private and public sector components, which could not be separated on the basis of available information. The data base and the listing of projects it contains should therefore be viewed as only a sample of AID private sector projects. This having been said, however, it is also the case that a large majority of projects are included and that the trends which emerge from their review are indicative of the progress of the program as a whole. Table 3 briefly summarizes the current contents of the data base.

A total of 211 private sector projects have been identified. Of these entries, 196 contain life-of-project budget information and therefore form the basis for the summary tabulations presented below. Of these 196, 38 projects are currently listed as "planned" in the CDIE/DI project information listing. These include some projects initially scheduled for FY 1984 obligation, indicating that they may now be active but are not yet recorded as such.

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Table 3. Summary of the AID Private Sector Projects Data Base

Item	Number
Total Number of Projects Identified	211
Projects With Full Cost Information	196
Active or Completed	(158)
Planned	(38)
Of 211 Identified, Projects With Specified Characteristics	
PRE Portfolio	37
Implemented Through Private Organizations	66
Other Donor Participation	31
Commercial Bank Financing	16
Focus on Investment/Export Promotion	17
Focus on Policy Reform	41
Focus on Training	73
Focus on Technology Transfer	40
Focus on SMEs	55
ESF With Private Sector Focus	12
Implemented Through PVOs	34

Table 3 also indicates the total number of projects identified that exhibit specific characteristics that may be of interest to future researchers. For example, 31 projects involve other donor participation and 16 involve commercial bank financing. Projects meeting the characteristics specified in Table 3 are listed separately in Appendix C.

Table 4 presents a breakdown of the number and value of private sector projects by main sector and date of initial obligation. As shown, the 196 projects for which cost information is available add up to slightly over $2 billion in new starts over the 4-year period since 1981.

This figure includes 12 instances of nonproject assistance, through commodity import programs, economic and/or balance-of-payments support. While these loans reflect a new use of the ESF -- having been structured in a manner that specifically directs at least a portion of the resources involved to the private sectors of the recipient countries -- the extraordinary circumstances under which such assistance is provided, and the size of the loans somewhat distort the picture on the progress of the Private Sector Initiative.

Excluding program loans of this type ($804 million) reduces the cumulative total of private sector project lending to about $1.2 billion. The sectoral distribution of this total is approximately as follows:

Sector	Percentage
Multisectoral	34
Financial	26
Agriculture	16
Agribusiness/Industry	10
Education/Training	10
Other	4
Total	100

Multisectoral projects, as defined for this study, include projects oriented to supporting policy dialogue and reform; enterprise development projects, both urban and rural; support for business associations; and investment or export promotion. This is the largest single category of private sector projects, both in number and funding, which is consistent with the multisectoral nature of private sector development.

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Table 4. Number and Value of Private Sector Projects With Full Cost Information by Start Year and Main Sector, FY 1981-FY 1984

Main Sector	Start Year Unknown	FY 81	FY 82	FY 83	FY 84	Planned [a] Projects	Total
Agriculture	0	2	5	4	4	2	17
$(millions)	0.0	13.8	28.5	28.6	109.0	12.5	192.4
Agri- business	0	1	2	2	4	4	13
$(millions)	0.0	6.0	11.5	4.5	22.0	17.6	61.6
Industry	0	1	4	2	2	3	12
$(millions)	0.0	5.0	10.5	1.7	21.0	24.9	63.1
Financial	0	2	8	12	3	6	31
$(millions)	0.0	10.2	95.2	128.9	30.1	52.0	316.4
Marketing	0	1	1	2	1	1	6
$(millions)	0	2.5	4.2	5.2	8.2	6.5	26.6
Housing	0	0	2	2	0	2	6
$(millions)	0	0	.7	.8	0.0	3.0	4.5
Health	0	1	0	0	0	1	2
$(millions)	0.0	5.6	0.0	0	0.0	5.0	10.6
Education	1	1	5	5	5	5	22
$(millions)	1.0	2.4	29.8	45.5	15.6	29.5	123.8
Multi- sectoral	3	11	26	17	7	11	75
$(millions)	2.3	51.9	152.3	117.0	38.7	50.1	412.4
ESF/CIP/BOP [b]	2	1	1	4	1	3	12
$(millions)	30.0	240.0	100.0	265.0	50.0	119.0	804.0
Total	6	21	54	50	27	38	196
$(millions)	33.3	337.4	432.7	597.2	294.6	320.1	2015.4
Net of ESF	3.3	97.4	332.7	332.2	244.6	201.1	1211.4

[a] Some projects identified as planned may have been obligated in FY 1984. The apparent decline in FY 1984 funding may therefore be inaccurate.

[b] ESF Economic Support Fund; CIP = Commodity Import Fund; BOP = Balance of

Payments.

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Capitalization of financial intermediaries, both public and private, for on-lending to the private sector, has been the second most important area of activity. Generally speaking, these projects have been targeted to specific segments of sectors -- such as SMEs or agribusiness.

Many projects identified as having a focus on agriculture also involve significant off-farm components or agricultural activities other than production. Examples include a shrimpery project in Antigua, fertilizer distribution in Bangladesh, seed multiplication in Cameroon and Thailand, and the Joint Agricultural Consultative Corp. Agricultural projects accounted for l6 percent of private sector project funding during l98l-1984.

Assistance to agribusiness and industry, other than through financial intermediaries and management/vocational and other education projects, each account for roughly 10 percent of the portfolio. Examples in the first category include agribusiness promotion in the Dominican Republic, meat processing in Thailand, and assistance to small-scale manufacturers in Jamaica. Educational projects include the INCAE expansion in Central America, private sector management training in Jamaica, and a workforce and skills training project in Botswana.

AID private sector project lending more than tripled in volume between 1981 and 1982, but appears to have leveled off at slightly over $300 million per year since then.{11} This amount corresponds to 16-18 percent of total AID development assistance over the FY 1982-1984 period, and to about 12 percent of Development Assistance plus ESF.

Table 5 provides a breakdown of cumulative private sector funding by region. Excluding ESF, the Latin American and Caribbean region has accounted for 43 percent of total private sector outlays, followed by Asia with 24 percent. Africa and the Near East follow with 13 and 10 percent, respectively, while about 11 percent has been central bureau disbursements for projects with a worldwide scope.

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Table 5. Number and Value of Private Sector
Projects With Full Cost Information
by Main Sector and Region
FY 1981-FY 1984
(includes planned projects)

Main Sector	Latin America/ Caribbean	Asia	Africa	Near East	World-wide	Total

Agriculture	8	3	4	0	2	17
$(millions)	36.2	112.6	39.1	0.0	4.5	192.4
Agribusiness	10	1	1	0	1	13
$(millions)	54.6	2.5	2.0	0.0	2.5	61.6
Industry	3	3	3	3	0	12
$(millions)	26.5	10.3	20.3	6.0	0.0	63.1
Financial	18	4	2	3	4	31
$(millions)	101.9	100.8	5.1	87.1	21.5	316.4
Marketing	3	0	1	0	2	6
$(millions)	18.9	0.0	2.8	0.0	4.9	26.6
Housing	6	0	0	0	0	6
$(millions)	4.5	0.0	0.0	0.0	0.0	4.5
Health	2	0	0	0	0	2
$(millions)	10.6	0.0	0.0	0.0	0.0	10.6
Education	13	3	2	3	1	22
$(millions)	77.2	12.0	18.6	12.4	3.6	123.8
Multisectoral	36	9	12	2	16	75
$(millions)	177.8	48.9	75.1	13.0	97.5	412.4
ESF/CIP/BOP [a]	10	0	2	0	0	12
$(millions)	653.0	0.0	151.0	0.0	0.0	804.0
Total	109	23	27	11	26	196
$millions)	1,161.2	287.2	313.9	118.5	134.5	2,015.4
Net of ESF	508.2	287.2	162.9	118.5	134.5	1,211.4

[a] ESF = Economic Support Fund; CIP = Commodity Import Fund; BOP = Balance of Payments.

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By sectors, the distribution of regional disbursements is shown in Table 6.

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Table 6. Percentage of Private Sector Project Obligations by Sector and Region

Sector	Latin America/ Caribbean	Asia	Africa	Near East	Central Projects
Multisectoral	35	17	46	11	72
Financial	20	35	3	74	16
Agriculture	7	39	24		3
Agribusiness/Ind.	16	5	13	5	2
Education/Trng	15	4	12	10	3
Other	7		2		4
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Total	100	100	100	100	100

Table 7 shows the evolution of private sector project funding over time for each major region. While LAC obligations began growing earlier than elsewhere, by 1983 and 1984 Asia was providing roughly similar levels of funding as Latin America in the private sector. Judging from the data base, it appears that projects in Asia are larger on average, but that more projects continue to be generated yearly in Latin America.

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Table 7. Number and Value of Private Sector Projects With Full Cost Information by Start Year and Region FY 1981-FY 1984

Main Sector	Start Year Unknown	FY 81	FY 82	FY 83	FY 84	Planned Projects	Total
Latin America	6	14	22	24	12	31	109
$(000s)	33.3	300.7	96.5	322.0	105.4	293.3	1,161.2
ESF/ CIP/BOP	30.0	240.0	0.0	214.0	50.0	119.0	653.0
Net ESF	3.3	60.7	96.5	118.0	55.4	174.3	508.2
Asia	0	1	6	9	5	2	23
$(000s)	0.0	5.0	19.0	125.0	133.0	5.1	287.2
ESF/ CIP/BOP	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net ESF	0.0	5.0	19.0	125.0	133.0	5.1	287.2
Africa	0	2	10	8	3	4	27

$(000s)	0.0	15.8	149.3	104.4	25.2	19.2	313.9
ESF/ CIP/BOP	0.0	0.0	100.0	51.0	0.0	0.0	151.0
Net ESF	0.0	15.8	49.3	53.4	25.2	19.2	162.9
Near East	0	2	2	2	4	1	11
$ (000s)	0.0	12.4	71.0	9.8	22.8	2.5	118.5
ESF /CIP/BOP	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net ESF	0.0	12.4	71.0	9.8	22.8	2.5	118.5
Worldwide	0	2	14	7	3	0	26
$(000s)	0.0	3.5	96.8	26.0	8.2	0.0	134.5
Total	6	21	54	50	27	38	196
$(000s)	33.3	337.4	432.7	597.2	294.6	320.1	2,015.4
ESF/ CIP/BOP	30.0	240.0	100.0	265.0	50.0	119.0	804.0
Net ESF	3.3	97.4	332.7	332.2	244.6	201.1	1,211.4

Note: ESF = Economic Support Fund; CIP = Commodity Import Program; BOP = Balance of Payments.

{11} Roughly one-third of the projects listed as "planned" by CDIE/DI have a 1984 initial obligation date and have probably become active.

3. A CONCEPTUAL FRAMEWORK FOR INTERPRETING PRIVATE SECTOR PROGRAMMING EXPERIENCE

After 4 years of expanded donor assistance to the private sector, it is appropriate to take a serious look at the approaches being used in light of this initial experience. Such an examination offers opportunities to draw lessons and to identify ways in which future programming might better apply donor agency resources in response to the needs of the private sector and development in general. Although the review undertaken for this study was not a comprehensive one, it provides the basis for preliminary findings on private sector programming, which are presented in this and the following chapters. These tentative conclusions serve not only to point up areas where assistance appears most useful and approaches that merit greater consideration, but also to support a better understanding of the private sector development task and how donor agencies can best position themselves to address it. The findings discussed below range from very specific suggestions to improve AID's own private sector program to broad principles that apply to private sector development as a whole.

3.1 The Nature of Private Sector-Based Development

To formulate effective programs to support the private sector, donor agencies must first understand how private sector growth occurs, what its requirements are, and what factors are most likely to constrain it. Although the need for this understanding is obvious, recent experience makes it apparent that donor programs have not always been firmly grounded in such an understanding. This section therefore offers some principles that appear to be broadly applicable to the complex but vitally important area of private sector development.

The principles elaborated here describe the process of private sector development as it occurs "spontaneously," that is, in the absence of major government or donor intervention to accelerate it. Governments and donors agree that this "spontaneous" development process is proceeding too slowly, and that intervention to speed the process is needed. This "supported" development process must, virtually by definition, differ to some extent from the "spontaneous" growth of private enterprise. Nonetheless, it is a key assumption of this report that, wherever possible, donor intervention should build on the underlying private sector growth process, rather than circumventing it.

3.1.1. Growth of the Firm: The Basis for Private Sector Development

The private sector is made up of individual firms producing goods and services for sale at a profit. It therefore develops through the creation of new firms and the growth and diversification of existing firms, expanding the production of goods and services.

This process is closely linked to the development of the society as a whole, although the two may diverge when there is market failure. For example, value-added from the firm's perspective may be more or less than social value-added if there are price distortions or significant externalities.

Despite these caveats, it is important to remember that there can be no private sector development -- and therefore no expansion of related benefits -- without the growth and development of individual firms. The primary requirement for the expansion of private firms -- the sine qua non -- is the existence of profitable opportunities. The absence of such opportunities is cited in the literature as the main constraint to greater private development in Africa and was frequently mentioned by staff at other donor organizations working in Africa.

This fundamental point gives rise to four observations that deserve special emphasis with regard to donor activity to promote private investment:

1. Provision of credit, technical assistance, and other support services will not attract investors to projects that have a low rate of return.

2. The rate of return to specific investments can be increased by donor and host government activity that affects the cost structure or the earnings of the enterprise.

3. Poorly designed policies -- such as price controls -- are a major factor underlying the absence of profitable opportunities in many countries of the developing world.

4. Interventions that dramatically reduce investment and operating costs or increase earnings -- such as road construction -- may have a greater impact than credit projects, which only reduce the expense of financing such costs.

Existence of profitable opportunities is a necessary but not sufficient condition. Entrepreneurs must also have the capacity to respond to profitable opportunities. This capacity may be separated into the following factors:

-- The ability to correctly identify profitable opportunities (with or without formal analysis)

-- The ability to mobilize capital, including equity, for investment

-- The ability to assemble key factors of production, including skilled and unskilled labor, the necessary inputs, and technology

-- The ability to organize and manage the production, marketing, and financial operation of the firm

3.1.2 Formation and Expansion of Markets

Governments produce and dispense services by and large without reliance on markets. Governments do not need markets to operate because they separate the two functions of service delivery (e.g., primary education) and revenue generation (taxation). Private firms, by contrast, are dependent on the existence of a market that enables them to sell what they produce (an effective demand, in economic terminology).

As economies grow, their markets expand and diversify in a process that parallels (but is by no means identical with) the expansion and diversification of production and productive firms. An example may clarify this concept. Consider a village where all clothing is produced by bringing cloth to a tailor to be made up. In this village there is no market for readymade clothing -- none is produced, none is sold, none is purchased. Now suppose a trader comes into the village with readymade clothing and sells it. There is now a market. The tailor may decide to purchase some cloth and try to sell some things readymade. If the tailor succeeds, the market for readymade clothing in the village may grow (and the market for tailoring services may diminish or disappear). Depending on where the tailor buys the cloth, how the operation is financed, whether a salesperson is hired, and so on, other markets in the village and outside it may also be affected.

This simple example illustrates one of the two processes underlying market growth: trade. A second, and often related process is technological_change. New technologies lead to the creation of new markets and the alteration (or disappearance) of existing markets. Technological change creates new products and new versions of existing products, all of which may be produced and sold, if there is a market. The development of a new technology is not sufficient to induce an entrepreneur to enter into production of the new goods -- the entrepreneur must believe that he or she can sell the item once it is produced. This belief may be based on a known market for a related product, trial sales, a powerful marketing strategy, or faith in his or her own good judgment.

To illustrate this process, consider the example of the tractor-drawn seeder. Although the tractor was initially developed for plowing, the widespread availability of tractor power created a potential market for a wide range of implements to make use of unused tractor capacity, and entrepreneurs responded with new products, including the seeder. Although some of these implements could have been developed for horse or oxen technology, in fact very few were. Development of the tractor-drawn seeder, in turn, created a demand for clean, standard-size seed. Even though the basic technology to develop such seed -- genetic selection -- had been in use for millenia, there was no market for this particular set of characteristics until the mechanized seeder was developed. When technological change created this new potential market, private providers responded with a new product based on additional technological change.

3.1.3 The Role of International Investment in Development of the Indigenous Private Sector

The two market-development processes outlined above -- trade and technological development -- provide the basis for understanding the role of international investment in expanding private sector production in the developing world. The potential benefits of international trade and investment are extensively analyzed in the theoretical literature on development, and need not be summarized here. Offshore firms support the expansion of private sector activity in developing countries by supplying information on and access to international markets for both inputs and final products, increasing the availability of equity capital, transferring technologies, and facilitating contact with offshore sources of credit, management skills, and technical expertise.

Analysis of the investment promotion experience of the IFC and its bilateral counterparts sheds light on the role of trade and technology transfer in laying the groundwork for international investment. This experience indicates that the greatest problem lies in initiating the process, not in supporting the investment once a decision has been taken and initial financing arranged. In this regard, the experience of organizations promoting such investments strongly suggests that, in the absence of energetic investment promotion activities, offshore firms rarely enter into joint ventures unless one or more of the following is the case:

1. The firm has already established a market in the developing country or the region that it wishes to expand or protect by producing its product in-country.

2. The firm already serves as a market for a product of the LDC (for example, a raw material such as wood) and hopes to reduce its costs or improve input quality by joining with its LDC supplier.

3. Factor market conditions make it desirable for the firm to move an existing production process to the developing country (for example, to take advantage of lower wages).

The last of these may result in the classic "enclave" investment, frequently criticized for its lack of forward or backward linkages to the productive economy of the developing country. By contrast, both of the other situations represent internalization of an existing international commercial linkage through investment. They therefore build on existing linkages between firms in the developing country and, in principle, have greater potential for expanding markets for goods and services in the developing country economy.

The critical point is that commercial linkages -- trade, in other words -- are often a precondition for "spontaneous" investment by the offshore firm. This is no more than business common sense -- serious investors are unlikely to enter a joint venture with a local firm they have not dealt with in a country where they have no experience to produce a product they do not know they can sell or use. (Where such investments are in fact profitable, investment promotion can be critical in bringing them about, because investors will rarely undertake them without assistance.) Stated this way, the point may appear self-evident, but it has three important implications for the design of successful investment promotion activities:

-- Trade often precedes local production, rather than substituting for it or preventing it; therefore, trade promotion (in either direction) can be an important source of future joint ventures.

-- Current trading partners are the best candidates for possible joint ventures.

-- Attempting to promote joint ventures in the absence of an established commercial relationship is doing things the hard (and expensive) way.

In general, it appears preferable to build on existing linkages, moving to promote wholly new ventures only when there are no suitable linkages on which to build. The PPC Special Study of the Thai seed industry demonstrates this process. Long-standing commercial ties between Thai traders and American seed companies paved the way for local production of vegetable seed in cooperation with the U.S. firms, once experience with rice seed had demonstrated and developed the market for purchased hybrid seed.

A second critical point is the linkage between trade and technology transfer, a link that complements the well-established connection between technology transfer and investment. An example from CDC experience expresses the concept most clearly. A British houseplant producer received CDC assistance for a joint venture to produce houseplants in a West African country. The decision to invest was based, however, on prior experience with the purchase of houseplants from a supplier in the developing country. This trade arrangement had led to technical assistance from the U.K. purchaser, motivated by a desire to improve the quality of plants being supplied, and had strengthened a contact that led eventually to the investment decision.

The PPC Special Study of small-scale machinery in Indonesia also indirectly illustrates this point. Although import restrictions were cited as an important factor in supporting the development of local manufacture, one of the firms studied had relied on import of machinery from Thailand as the source of prototypes applicable to Indonesian needs.

Technology transfer with little or no investment has become an increasingly important element in the development of LDC private sector enterprises, as new types of interfirm relationships have developed to replace direct investment. Technology licensing, management contracts, and other contractual agreements present alternatives to direct investment that reduce the exposure of the offshore firm while preserving and strengthening the commercial relationship. Trade is an important element in many of these new types of relationship.{12}

The basic model for private sector development programs that build on rather than circumvent the pattern of spontaneous development is the market-led process that begins most frequently with trade and progresses to technology transfer and direct investment.

By itself, this market-led process may be too slow or uneven to meet development goals. It does not follow an identical path in all cases (nor does trade necessarily lead to investment).

Where investment does result, it is usually the end product of a gradual evolution in the relationship, often over a period of a decade or more, with wide variation from case to case in the specific path taken. But trade is the starting point in the majority of spontaneous LDC-developed country ventures.

{12}See Charles Oman, New Forms of International Investment in Developing Countries (OECD, 1984), Oman for a complete discussion of recent experience with new forms of investment.

3.1.4 Constraints to Private Sector Development

As outlined above, private sector development may be viewed as an evolutionary process whereby individual firms are created, enter into production, expand, and diversify over time in response to market opportunities. This process can be constrained by a number of factors, including many outside the control of the firm:

- -- Constraints created by general economic conditions (international or national)
- -- Constraints in the capital market
- -- Constraints at the level of the firm or the local economy

These constraints either limit profitable opportunities or reduce entrepreneurial ability to respond to such opportunities. The appropriate role for donor and host government action to promote private sector development is the removal of these constraints.

Constraints at the Level of the Economy

Firms operate in the context of a national economy that can either encourage or discourage the expansion of production. They respond to prices and other signals that may lead investment in ways that maximize social well-being or distort investment, so that growth and equity do not reach their potential. Limiting factors arise from three sources:

- -- Government policy and regulatory action
- -- General economic conditions (only partly under the control of the national government)
- -- Basic infrastructure

Development professionals contacted as part of this review repeatedly emphasized the overriding importance of government policy and regulation in limiting the profitability of private investment. The litany of restrictive policies is depressingly familiar: overvalued exchange rates and restricted access to foreign exchange; limitations on imports and unduly high taxes on exports; price controls and profit ceilings; government-created monopolies and restrictions on who may produce or sell in the market. Again, programs to stimulate private enterprise are unlikely to be effective when the profitability of potential enterprises is called into question by policies that distort or artificially restrict the profitability of private enterprise.

Second in importance to policy constraints, and surpassing them in some cases, is the general condition of the economy, including both the national and the international economy. Often controlling high inflation is the single most important measure that a government can take to stimulate private sector expansion, without which other programs are unlikely to be effective. To say this is not to make the task of controlling the macroeconomy any easier, however.

Conditions seriously restricting the growth of the private sector -- or significant segments of it -- arise from a number of sources that governments influence but rarely control: (1) cyclical declines in aggregate demand (such as the recent worldwide recession); (2) crisis-related deficiencies, including wars, coups, and political turmoil; (3) the small size of some national economies, a function of population and income; (4) underdevelopment itself, which limits the range of goods and services that people are willing or able to buy; and (5) changes in world demand or supply conditions for particular goods.

Lack of basic infrastructure (power, roads, natural gas, telephones, water) increases the cost of production and, in many cases, makes it impossible. Government has a well-established role in providing such infrastructure, particularly roads and water, but it is important to emphasize that power, natural gas, and telephones can be and are provided by the private sector in many countries. Such services are generally considered to constitute natural monopolies, but this does not imply a national monopoly.

Constraints in the Capital Market

Development of private enterprise requires the mobilization of financial capital, the transfer of investable resources from those who have generated them (by saving, for example) to those who can put them to productive use. Except in command economies, this function is provided by the capital market.

To be effective, the capital market must be highly differentiated. It must provide financial resources under conditions that vary widely as to the following:

-- Term: working capital, short-term, medium-term, and long-term funds

-- Riskiness: continuing needs of established firms, new ventures of such firms, and wholly new ventures in sectors with varying riskiness

-- Amount: from tiny loans to microenterprises to multimillion dollar loans to major enterprises

-- Equity involvement: both equity capital and loan financing are needed

At different stages in their development, firms need access to capital with different mixes of characteristics. Small firms entering the market may be able to meet their own equity and initial investment needs, but have a need for working capital. They must be willing to pay the high rates necessitated by their small loan size and riskiness. Larger firms planning expansion may need both long-term loan and equity capital in large amounts, but may be able to finance working capital requirements for the venture internally.

Financial institutions position themselves across these capital markets in varying configurations. Commercial banks, for example, generally offer working and short-term capital in moderate to large amounts to established firms. Informal lenders offer short-term credit to small enterprises in high-risk markets where formal lenders hesitate to operate.

In many developing countries, the capital market is incomplete. For example, medium-term credit may be unavailable, or lenders may be unwilling to lend to high-risk enterprises because they are unable to charge an interest rate sufficient to cover their risk and expenses. The "missing" sections of the capital market tend to be those with higher costs, higher risks, and longer terms. Consequently, a financial institution operating only in a "missing" section may not be viable without continuing infusions of capital, unless it is able to raise its interest rate structure above that of competitors operating in a more attractive part of the market. As a specific example, development finance companies (DFCs) that lend to small, risky enterprises at the same rate as commercial banks lend to large, established businesses are likely to lose money.

The lack of equity markets emerges as a major barrier to new enterprises, especially at the larger end of the spectrum. An entrepreneur who does not have sufficient capital (or who does not wish to risk everything) may not have access to an equity market that permits him or her to bring other investors into the enterprise. Without additional equity investors, it may be difficult to establish the firm on a sound financial basis, with adequate capital and the appropriate mix of debt and equity.

Even when financial resources are potentially available for equity investment, the owners of such capital may be unwilling to invest it if there is no established equity resale market (e.g., a stock market) that enables them to draw out their earnings at a later time. The lack of such markets has proven to be a serious problem for donor-funded venture capital firms such as IFC and the West German DEG, which cannot withdraw gracefully from projects even after they have proven their viability.

Constraints at the Firm Level

The third type of constraints are those at the level of the individual firm. The major barriers to expanded private sector activity at this level include the following:

Limited Access to Technology and Information. In some cases, the technologies available for a particular production process were developed for a different set of input and product markets and are not appropriate to the entrepreneur's environment. In other cases, appropriate technologies exist but the entrepreneur cannot gain access to them because of a lack of information or the absence of a commercial connection to the source of the technology.

Poorly Developed Markets for Inputs and Outputs. An entrepreneur starting a business in a developed country benefits from the availability of skilled labor; specialized support services such as accountants, inexpensive transportation and communication services, and well-established networks of firms providing inputs (e.g., plastic bags for a commercial bakery), capital goods (e.g., specialized machine tools), services (e.g., repair of machinery); and a market for the product. By contrast, entrepreneurs in a developing country may have to perform many of these functions internally, thus increasing their costs and the demands on their management skills.

Lack of Management Skills. The growth and diversification of private firms requires management personnel with the ability to organize the productive and administrative work of the firm in a cost-effective manner.

Lack of Entrepreneurialism. Where private sector activity is not a well-established part of the economy, there may be a shortage of individuals with the attitudes, skills, and information needed to establish businesses. This problem is regarded as most serious in Africa and other low-income economies.

Of these constraints, the lack of an entrepreneurial group is perhaps the most challenging. Experience of other donors in West Africa, where a lack of entrepreneurialism is often cited as the major barrier to private sector development, suggests that the solution to this problem has three requirements:

- Profitable opportunities in productive enterprise. It is difficult to blame lack of entrepreneurship for slow expansion of production when poor policies, lack of infrastructure, and restrictive regulation make such activity unprofitable. By contrast, when these restraints have been removed, as in much of postwar Asia, entrepreneurial activity appears to have undergone a geometric expansion.

-- Elimination of profitable opportunities in nonproductive activity. Starting a productive enterprise is a risky and difficult activity. Enterprising individuals are not likely to take this path where opportunities exist to make a great deal more money through corruption, smuggling, importation of luxury goods, and "pseudo-enterprises" formed to take advantage of subsidized credit and other incentives.

-- Time. The 4 decades since the end of World War II have witnessed the transformation of Asia's traders into a dynamic entrepreneurial class. In Africa, the formation of the mercantile class has made considerable progress in the 20 years since independence, but additional development of internal and international trade activity will probably be necessary before the takeoff into entrepreneurialism.

3.2 AID Programming Considerations

The nature of private sector development -- both constraints and opportunities -- defines the framework for donor assistance to the private sector. In effect, it sets limits to the demand for donor assistance. To design and implement an effective program to meet this demand, however, it is necessary to consider the supply side of the equation: application of donor resources and expertise to meet private sector needs.

The purpose of this analysis is not to determine whether assistance to the private sector is appropriate -- clearly the need for such assistance is very great -- but rather to identify which aspects of the problem offer the best match to existing or potential resources within the donor agency. Since the universe of need is much greater than the donors' resources, the efficient and effective allocation of these resources merits priority consideration.

AID programming should be guided by the principle of comparative advantage, which argues that the key question is not whether an organization can perform a function, but which functions it can perform best.

3.2.1 AID Resources for Private Sector Programming

In the 4 decades since the inception of the U.S. foreign assistance program after World War II, AID and other agencies responsible for the program have developed a substantial base of experience, personnel, and operating systems. The understanding of the development task has evolved and the allocation of donor resources has shifted to respond to the redefinition of the donors' role in development. As a result of this evolutionary process, the Agency has developed the following resources and capabilities that define its comparative advantage in supporting private sector development:

-- In-country knowledge and capacity. USAID Missions are located in nearly every country where AID is active. These Missions, and the development personnel that staff them, give AID an in-country capability that other donors and other U.S. agencies generally do not have. This is particularly important as a source of support during program implementation.

-- Expertise in agricultural, rural, and poverty-focused development. AID's existing portfolio and manpower resources are particularly strong in the following sectors: agriculture and agricultural support services (e.g., credit); rural development, including small-scale enterprise development; and delivery of social services, particularly health and population.

-- Development focus. AID's commitment to growth with equity provides a necessary perspective on individual projects that is missing in agencies that do not have a sustained involvement in individual countries.

-- Growing expertise in identifying and removing policy constraints. Since 1980, AID has expanded considerably its capacity to engage the host government in a policy dialogue, building on previous Agency experience with policy-focused interventions (notably the program and sector loan programs of the late 1960s and early 1970s in Asia and Latin America).

-- Financial_resources. While AID funding levels are much lower than those of the multilateral lending institutions in nearly all countries, AID resources are substantially greater than those of the other bilateral donors, enabling it to undertake more ambitious programs and raising the potential for leverage.

-- Strong linkages to PVOs and U.S. private sector development organizations. AID has consistently utilized the capacity of the U.S. nonprofit sector, which possesses a range of capabilities suited to reaching small- and medium-scale entrepreneurs in the developing world.

-- A specialized office formed to serve as a resource for private sector programming and a source of new program approaches. AID's Bureau for Private Enterprise is unique among the donor agencies in its specific focus on the private sector. It constitutes a resource that has the potential to offer invaluable support to Mission programs and to undertake programming, such as U.S. backstopping for investment promotion, that no other part of AID can readily implement. This potential will not be achieved, however, if PRE misdirects its attention to programs that the Missions cannot replicate or substitutes its own program for support to the program of the Agency as a whole.

3.2.2 Limitations on AID Affecting Private Sector Activity

These advantages must be balanced against the following factors, which make AID more effective in supporting certain types of assistance to the private sector than in others:

-- Limited business and financial capability. AID staff are predominantly development professionals, with training and professional experience in the social sciences and technical fields (such as agronomy) related to AID's existing programs. These personnel have few of the specialized skills needed to undertake private sector activities, particularly in finance, trade, and marketing. Nor has AID committed the resources necessary to train existing staff in these areas or recruit personnel with these skills. The experience of the West German DEG indicates that this task is extremely difficult, even without the salary and other constraints on AID hiring, because personnel with business expertise in the developing world are highly sought after by the private banking and investment community.

-- Government-to-government focus. As a bilateral assistance program, AID is generally restricted to programs that provide assistance to or through host country governments. While PRE has begun to seek innovative means of obligating and disbursing funds directly to the private sector and much remains to be done in this area, it is virtually impossible for AID to undertake such activities over the opposition of the host government.

-- Organizational status. As an agency of the Federal Government, AID has certain fiduciary responsibilities for the responsible use of public monies. As usually interpreted, these responsibilities discourage risky ventures and any association with corruption, both factors associated with private sector programming in the developing world. A second problem related to AID's role in U.S. foreign relations is the potential for conflict (and conflict of interest) arising from close association with U.S. business interests, as well as the clash between the Government's interest in maintaining smooth relations with host governments, on the one hand, and the need to address difficult policy issues, on the other.

-- Procurement and other regulations. The Federal procurement regulations and AID's internal procedures for approving projects and managing funds promote a style of operation that is quite different from that of the private sector. In an effort to ensure accountability for public funds, AID has developed procedures that simply do not permit the speed and ease of operation associated with similar activities in the private sector. Again, AID could undoubtedly do more than it has to find ways to reconcile the need for accountability with the need for rapid action, but, as a Federal agency, AID does not have unlimited freedom to reshape its internal procedures. In this regard, it has less freedom than other U.S. Government agencies incorporated as semi-autonomous entities, such as OPIC and the Eximbank.

-- Limited contacts with the U.S. private sector. The location of the majority of AID's staff overseas greatly facilitates contact with the developing country private sector, but at the cost of much-reduced contact with the U.S. private sector. AID personnel are not generally familiar with the capabilities and interests of individual U.S. firms, information that is critical to the identification and realization of specific business ventures. In addition, AID as an agency does not have institutionalized procedures to acquire or update such information.

-- Lack of specific industry knowledge. Direct involvement in specific enterprises in developing countries requires in-depth knowledge of the particular industry -- be it the manufacture and sale of agricultural equipment or the export of computer components. AID personnel do not have this expertise, nor is there a feasible means by which AID could keep such personnel on the staff against the unlikely eventuality that their particular skill would be required. (Use of contract personnel and the pooling of specialized direct hire staff in central bureaus go part way to meeting this function, but there are limits to these approaches as well.)

-- Mission management resources. While AID capacity to manage field activities is much greater than that of the other donors and other U.S. agencies active in private sector development, there are very real limits to this capacity. Activities that require direct staff involvement in the identification and establishment of individual businesses are very difficult to support, given other demands on Mission management, unless intermediaries (PVOs, contractors) can be used.

-- Inability to take equity positions. At this time, no U.S. Government agency has statutory authority permitting it to take an equity position in a for-profit enterprise overseas. This function is regarded as critical by the IFC, DEG, CDC, PROPARCO, and other donor agencies that have experience with equity investment. While AID and other U.S. agencies can provide equity financing indirectly (as, for example, by providing loan financing to a development finance corporation or a LDC venture capital firm that takes equity positions), such measures are clearly an imperfect substitute for direct equity in their ability to leverage U.S. private sector involvement and to permit AID to participate directly in the management of the entities financed. This is not to argue that AID -- or another U.S. entity -- should necessarily be given equity authority. There are numerous risks and problems associated with Government-sponsored organizations taking equity positions overseas. The lack of such capability nonetheless is a major constraint on direct involvement in specific investments.

-- Need to avoid duplication with existing U.S. programs and focus on underserved areas of comparative advantage for AID. A range of U.S. and U.S.-supported multilateral agencies currently supports private sector activities in the developing world. In general, this activity is concentrated in two areas: (1) feasibility studies, investment promotion, loan financing, and insurance for U.S. direct investment and joint ventures and (2) financial support for state-owned development finance companies. It is clear that there is room for expansion in both the level of resources applied to these programs and in the scope of the programs themselves (particularly in investment promotion). If it is decided that additional resources should be allocated to these functions, however, it still remains to be determined which areas should be expanded or developed in agencies other than AID and which should be the focus of expanded programming within AID. More specific suggestions in this regard are presented below.

The foregoing list of strengths and weaknesses suggests areas where AID may have a comparative advantage in supporting private sector development as well as areas that appear to be less suited to its resource base. The analysis in the following section sheds additional light on this question by examining recent AID and other donor experience with alternative approaches to private sector development. Together with the foregoing discussion of the nature of private sector development, these analyses permit us to draw tentative conclusions regarding appropriate avenues for AID to pursue in strengthening and expanding assistance to the private sector. Although some of the findings on which the following discussion is based are presented in future sections, it nonetheless appears appropriate to draw them together here to highlight the study's implications for AID's Private Sector Initiative.

3.2.3 Implications for AID Programming

The review of AID and other donor support to the private sector suggests three areas of private sector development where AID resources are especially well-matched to the needs of the private sector:

1. Promotion of direct investment from the "LDC out" (explained

below)

2. Development of small- and medium-scale enterprises (SME) in developing countries, particularly rural, agriculture-related, or agribusiness enterprises, and institutions that support development in these areas

3. Support to policy reform directed toward encouraging private sector growth that is more rapid, more broadly based, and more effective in meeting development goals

Investment Promotion

The term "investment promotion" applies to a very wide range of activities, some focused on individual firms, some aimed broadly at sectors or whole countries, some taking the developed country investor as the point of departure, others beginning with the investor or the project in the developing country. Investment promotion encompasses generalized promotional activities intended to familiarize investors with overseas investing, highly specific assistance in finalizing the investment program and arranging financing for individual ventures, and everything in-between.

Within this extremely broad field of activity, AID can only be effective by identifying an approach that suits its capabilities. This approach must provide a complete package of assistance to bring potential investments from their inception as vague ideas all the way to fruition as actual investments, and, in some cases, continued assistance after the project begins. This does not mean that AID must complete all parts of the process itself, or that AID's investment promotion program must include all of the many activities that have at one time or another been carried out under the heading of investment promotion. On the contrary, AID needs a strategy of investment promotion that is internally consistent and complete.

The concept of "investment promotion from the LDC out" offers promise as a means of meeting this requirement. Since AID's mandate is to promote development in the LDCs and since most of AID's technical expertise and other resources are concentrated in the LDCs, the LDC private sector is the most appropriate starting point for AID investment promotion activities.

Such a program might include any or all of the following, as well as other activities not listed here, depending on the level of resources available and the needs and interests of the particular country:

- -- Identification of LDC entrepreneurs with project ideas suitable for support

- -- Assistance to these firms in carrying out feasibility studies and related analysis, with or without a developed country partner

-- Expansion of LDC entrepreneurs' knowledge of the international markets and potential U.S. business partners by supporting their attendance at U.S. trade fairs, providing training in export to the U.S. market, and so on

-- Partner search, to match investment opportunities in the country with appropriate U.S. investors, sources of technology, markets, and so forth, and to assist U.S. firms seriously considering investment in a particular country to locate local partners

-- Assistance to the LDC government and private associations to develop in-country capacity for investment promotion activities

-- Support to local business associations to encourage investment assistance to their members and to expand their field of activity

In other words, the focus of an "LDC out" strategy is the developing country private sector. Such a strategy would not involve any of the following activities:

-- Development of project ideas in the absence of a specific LDC investor potentially willing to make an investment

-- General promotion among the U.S. business community of investment overseas

-- Investment missions to the developing country prior to development of specific business ideas in cooperation with the LDC private sector

-- Support to LDC government investment promotion offices in the United States that are intended to develop ideas on their own, in cooperation with the U.S. private sector, or in response to suggestions of their parent government

Implementation of this strategy would clearly require, however, a focal point for U.S. activity, such as training for LDC entrepreneurs, partner search, attendance at U.S. business meetings, and so on. PRE would be a logical location for such a focal point, providing both technical and administrative backstopping. Programs in individual countries could follow a number of models. The German Business Cooperation program, with resident advisers located in LDC investment promotion offices, appears the most promising of the approaches used by the other donors.

Development of Small-and Medium-Scale Enterprise

AID is a leader among the donors in addressing the needs of small-and medium-scale enterprises (SMEs), both urban and rural, and has developed a number of innovative approaches to meeting the needs of this special group. Programs deserving particular emphasis appear to lie in the following three areas:

1. Use of PVOs to support SMEs, particularly those located in rural areas. Although PVOs are generally able to serve only a fairly small clientele with each project, they are the only institution that has proven itself consistently capable of serving this group at all.

2. Development of intermediate financial institutions serving small- and medium-scale enterprises, including DFCs. Support to this specialized financial market must give greater emphasis however, to the needs of the financial institution itself. Support to equity market development and strengthening of enterprise services (e.g., accounting, leasing) should also be explored.

3. Small- and medium-scale firms in agribusiness and related fields are a natural focus for AID activity in this area, not only because AID's technical strength is arguably strongest in agriculture but also because this subsector is by far the largest element in the private sector in many LDCs, especially those in Africa.

Support to Policy Reform

AID's initiative in policy reform constitutes a second area where the Agency is a leader within the donor community. The principal elements of the policy program, including dialogue, expanded support to local capacity, use of leverage and conditionality, and provision of financial resources, together constitute a well-matched set of instruments to influence policy reform in host countries. Experience to date with the policy reform initiative suggests that the following deserve additional consideration as the program matures:

- Use of private sector constraints analyses to focus the dialogue on those policies and regulations that are most damaging to private sector growth.

- Expanded allocation of resources to policy, to reflect the importance attached to reform in the particular country. If removal of policy constraints is in fact a

- precondition to economically sound private sector expansion, then the bulk of AID assistance should be directed toward encouraging this reform, to the extent that appropriate means of doing so can be found.

- More integrated approach to the policy dialogue process, applying the familiar principles used to manage the project portfolio -- planning and goal setting, resource allocation, monitoring, and evaluation -- to the policy dialogue process.

- Innovative programming of financial resources to increase AID's effectiveness in the policy arena. Possible avenues for such programming include:

  - Policy analysis support to development of a policy reform program suitable for a Structural Adjustment Loan (SAL), in close cooperation with the World Bank (Bank officials indicate that government inability to develop an acceptable SAL program is the major factor limiting more extensive use of this mechanism.)

  - Greater use of sector and program lending within a well-planned and carefully monitored program of support to policy reform

Program Development Needs

To develop a private sector program integrated into the mainstream of AID assistance programming, based in part on the three areas of emphasis outlined above, AID needs to develop its capabilities in several technical areas related to private sector promotion. Four areas deserving priority in program development are the following:

- Formulation of an investment promotion program approach to implement the "LDC private sector out" strategy. To accomplish this, the first step might be an in-depth review of AID experience in investment promotion, followed by a more intensive examination of the lessons from the German Business Cooperation program.

- Center of expertise in financial markets. Although AID has long made credit and development of financial institutions, including DFCs, a major part of its portfolio, there is no single office that serves as a resource for such programs. If this program is to be continued and expanded in the future, consideration should be given to establishing such a resource center to provide assistance to Missions planning credit activities, but also to explore innovative programs in the areas of equity market development, venture capital, and domestic resource mobilization.

- More effective mobilization of U.S. private sector organizations, such as industry councils. Experience with JACC, IESC, YPO, and so on indicates that these specialized organizations can play a useful role. To date, however, the Agency has made comparatively little use of the U.S. private sector's own organizations, such as the National Association of Manufacturers and the Chambers of Commerce. These groups have considerable potential for supporting the policy dialogue and other activities, as demonstrated by the ICD experience.

- -- Greater use of private sector delivery mechanisms. These should be used in AID programs that do not lie within the private sector, such as education and health. Experiments such as HEALTHLink should be closely monitored for lessons learned in this area, where AID is clearly the pioneer among the donors.

Areas That Should Not Be Emphasized

As with any innovative program, AID's Private Sector Initiative has experimented with some approaches that appear, on the basis of experience to date, to be comparatively less attractive for future AID programming. Three such areas are the following:

- -- Direct lending to individual firms. AID is by nature a "wholesale" agency, not a retailer. Direct loans to individual firms require a level of management support that is simply beyond AID's resources. Even if this support can be provided by a specialized organization such as PRE, it cannot be replicated in Mission programming. Financial institutions, including venture capital firms and possibly leasing firms, are an exception to this finding, because they "wholesale" assistance to a number of firms.

- -- Support to U.S. investors. Experience of the other U.S. and donor agencies in this area strongly suggests that it is not cost effective, given its high demands on management and generally disappointing results.

- -- Equity investment. A strong case can be made that the U.S. Government should consider establishing an equity-holding agency, along the IFC model. Such an agency should only be created if sufficient capital can be allocated to make the institution self-sustaining at an appropriate scale of operations. Whether an equity-holding agency were created within an existing agency (e.g., AID, OPIC) or set up outside the Government, its personnel and management structure would of necessity follow private sector rather than governmental models.

The first 4 years of the Private Sector Initiative have seen considerable progress toward a more balanced approach to development, one that recognizes the uniquely valuable contribution of markets and the private sector but does not turn away from the Agency's commitment to broad-based and equitable growth. These early years of private sector programming have permitted the Agency to experiment with innovative institutions and programs to address the needs of the private sector, as well as to revive, and reformulate for new uses, modes of assistance that had been used in the past with success.

If the next 4 years are able to sustain this pattern of innovative programs and management progress, the Agency must focus on the consolidation of the initiative around the most successful of the programs tried and on efforts to integrate these programs more fully into the mainstream of the Agency's assistance portfolio. This task of integration and consolidation presents as great a challenge to the leadership and imagination of AID as the initiative itself presented in 1981.

4. REVIEW OF ISSUES AND EXPERIENCE IN PRIVATE SECTOR DEVELOPMENT

This section discusses AID and other donor experience in the four main areas of the Private Sector Initiative:

- Policy reform
- Project assistance to the private sector
- Project assistance using private sector delivery mechanisms
- Mobilization of the developed country private sector for development

This review emphasizes experience since 1981, as captured in AID project evaluations and other studies completed over the past 4 years and in other donor experience. It also addresses the question of how these lessons have been incorporated to date into the evolving private sector portfolio.

4.1 Policy Reform

Increased emphasis on policy within the development profession is not strictly an outgrowth of the reorientation toward the private sector, but the two are closely related. Policy has been identified as the single most important and most prevalent factor constraining expansion of the private sector, on the one hand, while, on the other, the need to depend more heavily on the private sector as the engine of growth has reopened concern over policy's impact. From the specific perspective of the donors, increased channeling of assistance through private sector vehicles has highlighted existing policies as a key limitation on donor effectiveness, as well as on development overall.

Donor action to promote policies conducive to private sector expansion has taken four forms:

-- Policy dialogue, including direct discussions with the host government on the need for policy reform, analysis to support this discussion, and efforts to improve the donors' own understanding of appropriate policy changes

-- Increasing the supply of policy-relevant information, with a dual emphasis on direct action to increase information available to the government and support to the long-term development of indigenous capacity to analyze policy impacts

-- Leverage and conditionality, the linking of donor resources to specific policy change where the resources are being provided primarily for another purpose (usually a project)

-- Resource support to policy change, including resource transfers to accelerate policy change by offering funds as a concrete quid pro quo or to finance implementation of difficult reforms

4.1.1 The Policy Dialogue

Recent Experience

The Muscat report on AID experience with policy dialogue in support of private enterprise development provides an excellent overview of recent accomplishments in this area, together with a review of ways in which dialogue effectiveness could be increased.{13} Muscat's conclusions, which are reinforced by World Bank and other donor experience in this area, may be summarized as follows:

-- Where dialogue on an identifiable set of issues has been continued over a period of several years, concrete policy change has proven to be obtainable. For example, discussions and concrete assistance to Bangladesh have been instrumental in the privatization of fertilizer distribution.

-- Cooperation with other donors has been extremely important, but this does not imply a "me too" approach. Instead, AID can contribute to the dialogue by focusing on a specific issue within a larger dialogue that is of special interest to AID (such as management of an AID-assisted sugar mill in the Sudan).

-- Shifts in a country's circumstances create opportunities that can be capitalized on to achieve rapid change, when the government itself becomes open to such change and when previous dialogue has paved the way for a rapid response to the new opportunity.

-- The conduct of the dialogue benefits from greater use of a variety of vehicles -- consultative groups, private meetings, public conferences, and so on -- to match the level of dialogue to the specific needs and characteristics of the country. These vehicles might include greater use of development funds in direct support of the dialogue (e.g., program lending) as well as increased personal contact.

-- While the level of AID activity in a country is clearly an important factor conditioning the dialogue, funding of analysis and other activities in support of the dialogue can raise AID's policy impact even without a massive commitment of funds.

-- The essence of the dialogue lies in convincing host country officials at the policy and implementation levels to support policy reform. Training in Western analytical methods and support to expanded policy analysis within the country are key to creating a climate for such persuasion.

-- A change in rhetoric may be more difficult to achieve than a change in substance. Often a low-key change can achieve the desired purpose (as in the Sudanese sugar industry, where the Government agreed to bring in a private management firm for the sugar mill and to permit the mill to operate freely in the market), when a more complete change might be politically impossible. The dialogue should place results over ideology.

It is interesting to note that, despite the priority of the dialogue and the widespread perception that some dialogue activity is underway in most Missions, formal documentation of this activity and its result is virtually nonexistent. Dialogue activities are increasingly referenced in project design and evaluation documents, such as the evaluation of the Somalia Community Import Program (CIP), but the dialogue itself is largely undocumented. While this lacuna does not imply a lack of concrete progress in the dialogue, it does suggest that the dialogue could benefit from a more systematic approach to planning and monitoring. The present situation makes it extremely difficult to determine whether the dialogue is meeting with success or to draw lessons for application elsewhere.

Private Sector Constraints Analysis

The experience with the policy dialogue (to the extent that this review has been able to capture it) indicates that the impact on the private sector could be raised if the dialogue were based on a systematic analysis of the constraints to private sector development. Such an analysis, focusing primarily but not exclusively on policy and regulatory constraints, would be a valuable tool in support of expanded private sector programming, as well as the dialogue itself.

The emphasis on public sector approaches during the past decade has obscured the negative impact of the prevailing policy regime on the private sector. The response to perceived gaps in private sector activity has been, "What can the government do to provide the missing service?", not "Why is the private sector not responding to this apparent opportunity?" Now that the imperative nature of policy reform has been recognized, the formulation of a more desirable set of policies becomes a priority. The starting point for formulating better policies must be an attempt to answer the second of these questions.

In the past, assessment of private sector needs has been carried out in most instances on an informal basis as part of the design of particular projects. This approach has not encouraged a thorough examination of private sector needs as a whole or of the needs of particular sectors. On occasion, this partial analysis has led to programs being based on unverified assumptions rather than thoroughly demonstrated need. For example, credit programs developed to meet a perceived need for expanded availability of capital have on occasion required midcourse redesign or been less effective than intended because initial analysis failed to identify working capital as a necessary complement to term credit.

A private sector constraints analysis for a given country where expanded private sector programming is contemplated may be directed to the private sector as a whole or to specific subsectors of interest to AID. Given the crazy quilt of policies and regulations in some developing countries, an industry-specific analysis may yield quite different results than a more general overview of policy constraints in the private sector. For example, a World Bank-funded study of private agricultural machinery dealers in Egypt revealed that existing import regulations discriminate against some innovative types of equipment (two-wheeled tractors), a problem that might easily have been overlooked in an economywide review.

Even if a private sector constraints analysis focuses on a single industry, it cannot ignore the effect of policies and regulatory actions on the suppliers and marketing channels to which that sector is linked. For example, the inability of farmers to sell their products at a profitable price, because of government price controls, may be a major factor limiting demand for purchased inputs such as fertilizer (and therefore a major constraint to private sector fertilizer producers and retailers).

The experience of the Commercial Seed Industry Development Project is particularly illuminating in this regard. Implemented by a private multinational business association, the project was initially intended to provide technical assistance to the development of private seed industries in developing countries. Initial experience with this approach, however, convinced project managers that policy change had to precede any effort focused on technical problems. The project was redirected to include highly specific constraints analyses in countries where policy change was a priority. Discussions between the multinational association and the host government proved effective in convincing officials of the need for change in Turkey, Tanzania, and the Sudan. The evaluators of this experience felt that the association had been especially suited to this role because of its perceived expertise and independence from specific companies.

Private sector constraints analysis appears promising both as a guide to programming and as a means of identifying specific issues where dialogue could be fruitful. Constraints analysis also offers an opportunity to build Mission understanding of the private sector in a particular country, a precondition for improved private sector programming.

{13}Robert Muscat, "AID Private Enterprise Policy Dialogue: Forms, Experience and Lessons," prepared for the President's Task Force on International Private Enterprise, February 1984.

4.1.2. Increasing the Availability of Information

Donor assistance to policy formulation has taken the following forms:

-- Performance of specific analyses. For example, the World Bank often funds a technical assistance project as a companion to a structural adjustment loan, providing assistance with an agreed-upon agenda of policy issues.

-- Support to long-term policy-related research. AID has supported numerous projects designed to increase understanding of macroeconomic and sector dynamics through a modeling exercise or other extended research. The Rural Off-Farm Employment Assessment in Thailand and the Bangladesh Rural Finance Experimental Project are examples of such efforts.

-- Building of local capacity in policy analysis. Although AID and other donors have supported a large number of such projects, development of indigenous capacity to identify and address policy constraints has not generally been a priority. Policy components have occasionally been included in projects with a private sector focus, such as the Honduras Rural Technologies Project. Recent projects, such as the Policy Initiative and Privatization Project in Somalia and the Policy Analysis Project in Bolivia, are shifting in this direction, however.

-- Support to private sector groups and organizations active in policy discussion. Thirteen of the 33 new private sector projects with a policy component -- well over a third -- were identified as including private sector organizations as implementing agencies (individually or in cooperation with government entities). PRE has also funded a number of small experiments linking U.S. private sector organizations -- such as the Chamber of Commerce -- with sister organizations in the developing world.

It is difficult to draw lessons from this private sector experience, since most of the efforts specifically directed at private issues are relatively recent. Only eight project evaluations were found where policy analysis or support to policy reform was a major emphasis of the project. The experience of these projects, and others where policy became an issue and was addressed in the evaluation, suggests the following lessons, however:

-- A favorable government attitude and investment climate is extremely important to encourage business to expand. The value of government support to private enterprise was mentioned in the evaluation of the Upper Volta Rural Enterprises Project, the Entrepreneurship Training Program of the Lesotho Opportunities Industrialization Center, and PRE's Leather Industries of Kenya Project.

-- Market restrictions can give the appearance of favoring private sector development by providing short-term benefits to individual firms. These short-term benefits, which may be extremely attractive, often obscure the damage that these regulations can inflict on private sector development as a whole. Nonetheless, government use of its regulatory power to support, rather than inhibit, private sector development can be a powerful stimulant to such growth. The Korean case, discussed in a PPC special study,{14} illustrates the success that can be achieved when a government directs its regulatory power toward promoting an export-based growth strategy. The evaluations reveal several instances where private enterprises benefited from trade restrictions in both the developed and developing countries. The Sayyed Machinery Project, for example, is expected to benefit from government restrictions on continued importation of agricultural machinery into Pakistan, a factor also cited in the Indonesia Small-Scale Mechanization case. The Non-Traditional Exports Promotion Project in the Dominican Republic was designed in part to take advantage of special U.S. tariff provisions applying to the Caribbean.

-- Nonetheless, the long-term implications of these distortions for economic efficiency are severe. The liberalization of the Turkish economy created difficulties for private and public sector firms alike, since both had grown up in and adapted themselves to a heavily protectionist regime. Care must be taken to ensure that AID programs do not promote the granting of special privileges to a few firms, at the cost of more competitive, market-based growth. In this light, the CIP programs in a number of countries have been criticized for using a below-market exchange rate to attract private sector users who will be unable or unwilling to continue the trade contact on commercial terms.

-- Developing countries are experimenting with a number of innovative strategies to gain the benefits of a market orientation while continuing government equity participation. In some cases, this experimentation has been on an economywide basis, as in Malawi and Cameroon, while in others it has been on an industry-by-industry or firm-by-firm basis.

-- Support to LDC private sector institutions can be important in promoting policy reform, but must be pursued with great care. Business associations and other private sector groups have the potential to contribute greatly to the internal policy dialogue in developing countries, whether in cooperation with AID dialogue efforts or wholly separate from them. AID should search for constructive ways to involve local private sector organizations in the dialogue and policy reform and assist these organizations to become more effective in providing policy advice to their governments. In doing so, AID must be alert to the risk associated with politicization, which may ultimately weaken rather than strengthen the organization, especially if it leads to counter-action by the government or opposing interests.

As experience accumulates in this area, it will be extremely useful to continue to test these conclusions against an expanded base of project evaluations and the experience of the other donors.

{14}The Economic Development of Korea: Sui Generis or Generic? AID Evaluation Special Study No. 6 (Washington, DC: AID, January 1982).

4.1.3. Leverage and Conditionality

Perhaps no topic excites stronger feelings within the donor and recipient country community than the issue of leverage and conditionality. Many of the smaller donors have explicitly separated themselves from the policy dialogue in part because they believe effective dialogue requires a level of resources and a willingness to apply leverage inconsistent with their assistance strategies. AID finds itself in something of a "Catch 22" in this regard, since the programs with the most financial resources are precisely those where the level of the resource commitment is generally perceived to be fixed by broader foreign policy considerations.

Representatives of the British ODA describe their solution to this problem as one of choosing issues to address that appear to match the level of resources available. They plan to expand their policy-related activities, but to focus them on specific issues in their priority sectors (agriculture and small enterprise).

Even though AID has more resources at its disposal than other bilateral donors, the search for means of increasing leverage deserves a high priority. Three possible mechanisms for increasing the leverage impact of AID resources are as follows:

-- Closer cooperation with other donors in multilateral dialogue efforts

-- Support to country efforts to develop a Structural Adjustment Program (SAP) acceptable to the World Bank, when the Bank indicates its willingness to provide Structural Adjustment Loan assistance but the country is unable to formulate a program (a common problem, according to Bank officials)

-- Supplementing AID resources with those available through other U.S. agencies engaged in trade and overseas investment. For example, the U.S. Government might offer trade concessions as part of an assistance package in support of policy reform.

A key issue in regard to conditionality, and one which is far from resolved, is the extent to which leverage and conditionality should be or can be attached to specific projects, as opposed to program assistance or the overall allocation of donor resources. Two findings that seem to be confirmed by project experience are the following:

-- It is rarely advisable to link broad policy changes to specific projects, since governments are often more willing than AID to allow a project to fail or be cancelled.

-- If project success depends on a specific policy change, the project should not be obligated until the change is made. Although funding in a particular area gives AID legitimacy in discussing related issues with the government, only the promise of future funds creates actual leverage.

Both AID and the other donors -- most notably the World Bank -- have made increasing use of leverage and conditionality. Recent policy papers and other documents (e.g., Marsden's paper on cooperation between the Bank and private enterprise) demonstrate a commitment to expanded use of these strategies. Nonetheless, there appears to be a serious lack of systematic examination of experience with conditionality and leverage. A review of successes and failures in obtaining policy change using leverage and conditionality in both project and nonproject formats should receive serious consideration as a guide to more effective use of these approaches.

4.1.4 Resource Support to Policy Reform

As discussed in the historical review section above, AID made heavy use of program and sector assistance prior to the New Directions period. This assistance was often linked to specific policy changes, with mixed results. This early experience was the subject of a PPC review in 1970 which is summarized above and in the Policy Paper on Approaches to the Policy Dialogue.

Assistance in this area has taken essentially three forms, of which only the first two are directly related to policy.

1. Provision of financial resources in return for policy change. In this approach, now used primarily by the World Bank in its SAL program, a level of assistance is agreed upon and provided on condition that the government take certain agreed-upon measures.

2. Provision of resources to finance policy change. This approach calls for resources to be provided to buffer the government from the cost of implementing difficult measures. For example, resources may be made available to finance purchase of agricultural commodities from farmers at market prices, during a transition from low government-imposed prices to a market-oriented price regime. This approach has been used relatively rarely.

3. Provision of resources to support desired nonpolicy activities. Budgetary support, used primarily during the final years of U.S. aid to middle-income countries in South America, is an example of this type of assistance.

The linkage between program and sectoral assistance, on the one hand, and policy reform, on the other, is arguably more straightforward than the use of project assistance for this purpose. Once a project is in place, with its accompanying procurement and contracting activities, it is difficult to withhold resources when policy reforms fail to materialize. Effective use of program assistance, however, is not a simple matter either. The evaluation of the Industrial Production Project in Egypt concludes that:

> It appears that USAID may be moving toward a programmatic mode of activity without fully exploring and debating its previous performance as a project-oriented organization, and without considering whether the organization as a whole has developed patterns of behavior which may inhibit its new role as a "wholesaler" who can use leverage to influence policy or structural reform. In addition, there may be consensus evolving within USAID that places excessive emphasis on funding as the leverage for structural reform to the exclusion of other options.

Although ESF/CIP assistance accounts for fully 40 percent of AID private sector activities initiated in the past 4 years, evaluation of these programs is only now beginning. Only four evaluations of CIP or other program assistance activities were found during this review. Given the mixed experience with earlier program assistance, the renewed emphasis on policy as a major priority, and the change in the development situation since the 1970s, a more thorough review of this experience would appear to be extremely timely.

4.2 Project Assistance to Private Enterprise

The major focus of donor private sector assistance strategies has been project assistance directed toward strengthening the private sector in developing countries. This assistance has been directed towards:

-- Expanding the supply of capital to developing country firms

-- Expanding contacts with international markets and expertise

-- Improving technology and management systems used by developing country firms

Many of the projects developed using these approaches, singly or in combination, have been directed at the private sector in the host country as a whole, others have been targeted toward a particular segment of the private sector or to a specific subsector. The following target groups have been selected most often for special emphasis:

Segments: Small-scale enterprises (SSEs)
Medium-scale enterprises (MSEs)
Small- and medium-scale enterprises (SMEs)

Subsectors: Agricultural or agribusiness enterprises
Rural enterprises in general
Small traders
Health-related firms (e.g., retail outlets for contraceptives)

Before examining the lessons of experience in each of the three areas outlined above, therefore, it is useful to consider what has been learned about directing assistance to a special group within the private sector, regardless of the method of assistance chosen.

4.2.1 Targeting Special Groups Within the Private Sector

The targeting issue for private sector assistance raises two issues:

1. What is the rationale for focusing assistance and, in view of the associated advantages and disadvantages, when and where should AID assistance be targeted?

2. Do the most commonly targeted segments (SMEs) and subsectors (principally rural and agribusiness) have special needs distinct from the private sector in general?

Rationale for Targeting SMEs

While not all donor agencies target their programs to a particular segment or subsector, most do. Those that do not are predominantly those that support developed country private investment, such as OPIC, the IFC, and the DEG. As one official commented, these organizations will fund "any good project that walks in the door."

Most programs that work with host country institutions, however, target their assistance to SMEs and institutions designed to help SMEs, such as development finance companies (DFCs). The rationale for doing so is strong:

-- Most large-scale enterprises do not need (or particularly want) donor assistance.

-- In many countries, large-scale enterprises are almost wholly in the hands of the public sector, if in fact any exist.

-- The SME segment has a much better record in providing jobs and in creating linkages to the local economy for a given investment.

-- SMEs have relatively weak access to commercial sources of credit, technical assistance, and management support and therefore need special assistance.

These rationales have proven compelling, and most donors in fact focus private sector assistance on SMEs. In order to assist the SME sector effectively, however, experience underscores the need to look beyond the SMEs themselves in order to develop a response to their needs.

The first and most important reason for doing so is that assistance programs for SMEs frequently rely on large- and medium-scale enterprises as intermediaries. SME programs must consider the needs of these organizations as well as the firms they are intended to assist. For example, IFC personnel interviewed faulted the other donors for failing to recognize that a DFC portfolio consisting exclusively of small, risky, high-cost loans to SMEs is virtually a recipe for insolvency. Thus, efforts to direct programs at the SME segment must be designed so as not to undermine the profitability of the intermediary institution.

Even when the intermediary is a nonprofit or the donor agency itself, the management cost issue cannot be ignored. Several of the other donor agencies commented that direct support to SMEs is not cost-effective for the donor agency and is tremendously demanding of donor management time. A recent AID review of SME programs found them to be economically attractive, but prone to financial difficulties because of the high cost of reaching such firms.{15}

To address this problem, a subsidized intermediary, such as a private voluntary organization, has often been chosen as the most viable approach to assisting firms at the lower end of the spectrum. Such organizations are regarded as legitimate targets for nonmarket support because they provide a service that is recognized to be unprofitable. Experience with such organizations, however, suggests that there has been a tendency to confuse the need to subsidize the service to make it feasible with the desirability of subsidizing services to small enterprises. Whereas in theory, such firms should pay a higher interest rate than larger firms because they are higher risk customers, PVO programs have tended to charge a below-market rate, instead. This is a mistake, because it undermines the financial viability of the PVO and gives inappropriate market signals to the SME.

A second reason for broadening the focus of analysis is the crucial role that larger firms can play in supporting the growth of smaller firms. Larger firms often serve as the market for the products of smaller firms, or the source of their inputs, linking the growth of the two segments. Promotion of subcontracting by larger firms, for example, offers promise as a means of assisting SMEs.

Rationale for Targeting Rural Enterprise

The rationale for concentrating on the rural and agriculture-related subsector is equally compelling, although quite different.

1. Rural and agriculture-related enterprises are especially well-suited to providing jobs, services, markets, and products to the poor majority, who continue to be the ultimate target for AID and many bilateral donors (e.g., ODA).

2. Location in rural areas creates special disadvantages, such as lower access to formal credit, that provide a rationale for donor involvement.

3. Public sector involvement has been weighted toward large, urban-industrial projects. As a result, the most "truly private" enterprises tend to be in the rural areas.

Coupled with these developmental rationales for focusing on certain subsectors of the developing country private sector are several very practical reasons for doing so. First, effective private sector programming requires a thorough knowledge of the local private sector. It is difficult for a USAID Mission in any but the smallest country to gain an understanding of the private sector as a whole. Consequently, it makes sense to focus on a manageable part of the total, so that staff are able to build up the necessary knowledge base. If AID is to focus its efforts, it seems obvious that the Agency should select areas where it has been most active and where Mission expertise is strongest. At the present time, agriculture and rural enterprise are clearly the areas of greatest AID knowledge (excluding the social services and other sectors not generally classified as income generating).

Second, assistance to the local private sector requires a combination of technical as well as financial and management-related skills. Those developing and implementing projects must have an overall understanding of the special needs and characteristics of the industries to be assisted. (For example, do firms require a certain minimum size for viability? Are there important seasonalities that raise the need for working capital?) At present, AID has only very limited staff with practical knowledge of production processes, and almost none outside of agriculture.

The other skills needed to assist the private sector -- marketing, finance, and so on -- are also very limited in the Agency. To make the best use of these extremely limited Mission resources, it is important to avoid spreading them so thinly that they cannot be effective. The management challenge facing the Agency is to find ways not only to strengthen these two critical skill areas -- managerial and technical -- but also to develop better mechanisms to bring the two halves of the problem together. One way to do so is to limit private sector activity to areas where the two intersect.

Special Needs of Priority Subsectors

With regard to the second issue -- the existence of special needs among SMEs or rural enterprise -- the experience is less clear. On balance, it appears that these businesses have the same needs as other enterprises, but they have more difficulty in meeting them for a variety of reasons. These reasons have important implications for programming directed at these two, overlapping target groups. They include the following:

1. Economies of scale on the supply side. Because it costs nearly as much to administer a small loan as a large one, lenders prefer to deal with large clients.

2. Economies of scale on the demand side. Large firms can spread a unit of assistance -- for instance, a day of an accountant's time -- over their entire operation so that it becomes affordable, whereas small firms cannot make good use of a proportionately smaller level of assistance -- say 10 minutes of the accountant's time.

3. Poor access to information and technology. Smaller firms are generally managed by individuals with less formal training in skills that permit them to tap the technical and business resources in their economy.

4. Riskiness. All business is risky, but small firms fail at higher rates than do larger firms because they are less able to weather shocks such as an economic downturn, a

change in an important market, or the loss of a key person. DEG has found, for example, that a major problem is failure of smaller German firms with which they are cooperating, even where the DEG-supported LDC venture itself is highly profitable. Thus, programs directed at SSEs must be sufficiently flexible to meet rapid changes in their financial status.

Several of the reports on which this study is based concluded that, contrary to many project design documents, credit access is not the only -- or even necessarily the major -- constraint facing the private sector. Limited access to credit may indeed be a serious problem for LDC private sector firms, but lack of technical and management skills, limited markets, and, in particular, lack of equity financing may be equally limiting. The evaluation of PfP's successful Kenyan program, for example, concluded that the small entrepreneurs assisted generally had adequate access to capital, but were unable to use it efficiently due to management problems. The DAC review of assistance to SSEs also concluded that "lack of investment capital is seldom the primary deterrent to small business investment, although it is often so described by small entrepreneurs." Donors have too often been tempted by the natural fit between donor resources (i.e., money) and credit programs and have therefore not examined as closely as they should have the assumption that improved access to credit will be sufficient to ensure rapid private sector growth.

{15}Peter Kilby and David D'Zmura, "Searching for Benefits," (draft), May 1984.

4.2.2 Expanding the Supply of Capital

At the outset it is important to emphasize that while the financial sector and financial policies are crucial to LDC growth -- therefore constituting a major area of donor involvement -- not all of the burden of development can be placed upon them. It has been a repeated finding of special studies and evaluations of DFCs that distortions in the allocation of capital resources are as much the consequence of policies affecting the "real" sectors of the economy as they are of supply-side policies directly affecting the pricing and allocation of capital. Trade and foreign exchange policies, wage and other factor market distortions, and the fiscal performance of the government each affect the composition of demand for capital, and the efficiency of its ultimate utilization, in ways that financial sector institutions and the instruments of monetary policy are unable to control. Interventions to assist in the expansion of the supply of capital depend crucially, just as do those in other sectors, on the broader policy environment discussed above.

Development assistance organizations can influence the availability of capital in LDCs through either or both of two basic approaches. The first consists of the transfer of external resources -- through grants, loans, or direct investments. Alternatively, donors may focus their efforts on assisting in the improvement of domestic resource mobilization and allocation in LDCs -- through promoting policy and regulatory reform, supporting the development of new financial institutions, or increasing the efficiency of LDC financial intermediaries through technology transfer, technical assistance, and training.

AID and other donor projects generally include aspects of both approaches. Recent projects increasingly emphasize the importance of improving the efficiency of domestic resource mobilization through supporting the development of an appropriate policy, legal, and regulatory environment, and a variety of institutional development efforts. The debt crisis has pointed to the need for a greater degree of LDC self-reliance in generating the savings to finance investment, and experience has shown that even very poor countries can, with the right policies and more efficient institutions, improve their performance in mobilizing their own resources. It has also been observed that, in the absence of these elements domestically, external resource transfers have seldom fully achieved their intended developmental impacts. Measures to improve the functioning of LDC domestic financial systems are in some sense "prior" to resource transfers and are discussed first below.

Donor Assistance in Improving LDC Domestic Resource Mobilization

Few areas of business activity are so closely regulated by governments as is the business of borrowing and lending money. Banks and other financial intermediaries in many countries, particularly in many developing countries, are subject to controls that stipulate the price that can be paid to acquire loanable funds as well as the price which can be charged for lending them. Because these prices are generally maintained at artificially low levels, both domestic savings and the supply of loanable funds mobilized from savings are severely restricted. Within the context of restricted aggregate supply and controlled prices, market allocative mechanisms generate a tendency for lending to be selectively concentrated in low-cost markets because only these can be profitable under such conditions. A bias towards large loans, at short term, to well-established borrowers, is typically introduced.

To counteract this natural market response to the first round of government restrictions, governments -- and donors -- often react by imposing a second round of restrictions, a system of quotas obliging commercial lenders to distribute predetermined portions of their portfolios among specific economic sectors or market segments. Common examples are regulations or conditionality that requires that specified amounts be directed to agriculture or to some specific class of borrowers such as small-scale enterprises.

Finally, licensing and other regulatory procedures often impose formidable barriers to entry which restrict the number and competitiveness of firms offering financial services on a commercial basis. Large segments of the market -- long-term lending, venture finance for startups, and small business lending in both urban and rural areas -- are typically left unserved or underserved under these conditions. "Informal" lenders, both large and small, who do venture into these areas generally do so beyond the pale of the law, assuming risks that go beyond the risks involved in the lending transaction itself and extracting extraordinary profit margins in return.

As discussed in Section 2, government-induced price distortions in LDC financial markets have been shown to be a major factor in depressing domestic savings rates. The World Bank study cited there showed that countries with highly distorted capital markets averaged only a 14 percent domestic savings to income ratio during the 1970s compared with 21 percent for countries relying more heavily on markets to determine interest rates. What is more, in countries with highly distorted capital markets much of the domestic savings that are generated elude the financial system, finding their way into speculative investments in real estate, foreign currencies, and other nonproductive "hedges."

The insufficiency of domestic resources mobilized by LDC financial systems is directly linked to their increasing dependence on external borrowing during the 1970s and the critical external debt situation that afflicts them today. The severity of this debt crisis and the existing debt service obligations of many LDCs -- a burden which will in many cases extend into the next decade -- clearly limit their ability to assume additional indebtedness and caution against excessive donor reliance on increased lending as a means of expanding the supply of investment capital in LDCs.

During the upcoming decade efforts to augment the supply of investment capital in developing countries will need to focus more closely on the expansion of domestic savings in LDCs, improving the efficiency of their capture and intermediation by the financial system, on reducing government deficits, and on encouraging the flow of investment -- both direct and portfolio -- from the developed countries to the developing countries.

Most such investment capital will need to be provided by developed country private investors, who are only likely to do so in significant amounts if the investment climate and growth prospects in LDCs, which depend significantly on monetary policies and the functioning of their financial systems, provide a reasonable basis for the expectation of stability and profits. Improvements in the functioning of LDC financial markets are thus crucial to the more effective mobilization of both the domestic and the external resources which will be required to sustain development in upcoming years.

Governments and donors have traditionally provided earmarked resources at below-market rates of interest to support lending in priority sectors. These subsidized rates provided financial intermediaries with the spread necessary to enable them to service higher cost or higher risk markets within the lending rate ceilings established by local monetary authorities. Noncommercial lending programs to small, unsecured borrowers have usually involved the services of a voluntary or cooperative organization and the provision of financial resources on concessional terms.

While concessional assistance of this kind, and the subsidization it facilitates, will no doubt remain an element in supporting the development of financial services in LDCs, both governments and donors appear to agree on the need to reduce the levels of, restrict access to, and devise alternatives to subsidies as a development tool. Private sector development approaches can provide such alternatives and may be particularly appropriate to the current financial situation of LDCs in which indebtedness severely restricts the scope of direct action by the public sector. Private sector development priorities in the financial sector include the following:

-- Policy, legal, and regulatory reform

-- Technical assistance, technology transfer, and training

-- Support for the development of new financial institutions

Policy, Legal and Regulatory Reform. Promising areas for government policy attention in the financial sector of many LDCs include the following:

-- The liberalization of financial markets to permit prices to adequately reflect costs

-- Measures to reduce barriers to entry and stimulate more effective competition

As was discussed earlier in this report, the financial needs of enterprises are diverse. Commercial transactions may only require short-term financing while capital investments require a longer period for installation, startup, and cost recovery. Both commercial operations and capital investments vary immensely in the degree of risk involved. Individual borrowers are themselves more or less reliable risks. Individual loan requirements vary widely in size but much less widely in the lender's administrative costs. Individual projects vary in terms of the repayment profile that can be sustained by cash flow.

Each of these elements has a distinct influence on the costs or expected costs of serving borrowers. A wide range of borrower classes exists, and expected costs -- influenced heavily by the probability of timely repayment -- can vary from borrower to borrower within a class. Despite this diversity, however, financial institutions in developing countries are often expected to serve each of these markets equally well within what is usually a very narrow band of regulated prices. Similarly, they are expected to attract the resources needed to serve this diversity of markets by offering to depositors and bond holders what amounts to a fixed price. These are clearly financial impossibilities, and it should come as no surprise to find that commercial financial institutions have, under these conditions, shunned all but the safest markets.

Governments in many countries, developed and developing alike, have come to realize the need for greater flexibility in permitting pricing in the financial sector to more closely reflect the diversity of costs. The potential responsiveness of the commercial financial sector to meeting a diversity of needs, at different costs and prices, has been demonstrated by recent U.S. experience with deregulation. Equally important and meaningful experiences are beginning to emerge from some developing countries which have opted to relax some of the traditional controls imposed on the financial sector.

A highly relevant example is AID's recently evaluated Rural Finance Experimental Project in Bangladesh. In this project, rural bank branches were permitted to experiment with lending rates of up to 36 percent (versus an 11 percent Central Bank ceiling and 100 percent or more charged by moneylenders) in loans to small farmers and rural producers. Deposit rates of up to 15 percent were also permitted (versus a Central Bank rate of 7.75 percent). Over 5 years, the project produced over 80,000 loans with many repeat borrowers at rates of up to 30 percent. Overdues averaged 19 percent versus a national average for rural loans estimated at from 30 to 40 percent. Significantly, one participating bank was able to raise rural deposits from the equivalent of about 13 to about 38 percent of its loan portfolio in less than 1 year, by paying the higher deposit rates. (Many participating banks were reluctant to implement higher deposit rates, fearing a commitment which might outlast the term of the experimental project). Four out of the nine participating banks, who accounted for 68 percent of total lending under the project, operated profitably -- something of a rarity among the state-owned rural branch banks of Bangladesh. To continue to function, moneylenders in the areas served by the experimental project were forced to halve their accustomed lending rates to a range of from 40 to 60 percent.

ACCION/AITEC is currently implementing a similar lending program for micro and small-scale borrowers in Ecuador, apparently with equally encouraging results.

The lesson of these experiences, limited though they may be, is that a significant unmet demand for credit exists at a price sufficiently high to cover the high transactions costs -- administrative costs plus default risk -- inherent in underserved LDC credit markets. It is also that these markets, previously neglected or relegated to the moneylenders, can begin to be commercially served with the liberalization of controls on interest rates. With the initiation of commercial credit service to these sectors on a significant scale, it is likely that transaction costs and interest rates can be gradually reduced through the accumulation of experience, the effects of competition, and the influence of technological change.

Donors might be encouraged to pursue further experimentation of this kind, along with dialogue on policy and regulatory reforms to foster the commercial replication of successful approaches. A second major area of attention would then become that of assistance directed at reducing the transaction costs involved in serving nontraditional credit market.

Removal of legal restrictions affecting certain categories of informal lenders, and other legal measures to permit the entry of new forms of specialized lending institutions -- ranging from community organizations to venture capital companies -- can also reduce transaction costs and contribute to the efficiency of financial services. Donor assistance may be required in the analysis and development of alternative legal structures and in the initial capitalization of experimental forms of financial sector institutions.

Technical Assistance, Technology Transfer, and Training. Improved financial management systems, ranging from simplified loan appraisal procedures to small-scale computerized information systems, can help financial institutions to better control their lending operations, reducing default risk at a lower administrative cost, and thus reducing total transaction costs of credit in nontraditional markets. The development, testing, and dissemination of cost-reducing innovations suitable to the requirements expanding LDC financial sectors are activities for which a growing need can be anticipated.

Cost-reducing technical assistance and training can extend beyond the credit institutions themselves to include their clienteles. Examples of recent projects involving such assistance to borrowers include AID loans to the Siam Commercial Bank, the Kenya Commercial Bank, and the Royal Bank of Jamaica. In each of these cases, a portion of the resources provided has been allocated to the provision of business advisory services and training to SME loan recipients. To the extent that these services are effective in improving project preparation, financial management, and business administration among borrowers, lending costs to this group could be reduced.

Some important issues have been raised with respect to this kind of assistance, however. They include cost-effectiveness, particularly in the context of service to microenterprises (see Kilby and D'Zmura, "Searching for Benefits" for some negative findings), and the potential liabilities of lending institutions when, serving both as creditor and advisor, borrowing enterprises fail. This difficulty suggests the possible desirability of institutionally separating the credit and technical assistance functions while retaining both elements in the design of credit programs.

Support for the Development of Financial Sector Institutions. Loan capital cannot adequately serve all of the financial needs of accelerated private sector development. The lack of access to equity capital and the absence of capital markets in many LDCs are repeatedly cited in AID Special Studies and by other donors as important constraints to the development of private enterprises. Equity finance is needed by both large and small firms, with organized capital markets perhaps better suited to the needs of the former, and venture finance organizations better positioned to support the latter. AID is becoming increasingly active in this area of institution building, in the company of other donors such as the IFC and the German DEG.

It is to be expected that the development of functioning capital markets and successful equity investment organizations in many LDCs will be a gradual process. Enterprises in a majority of such countries are closely held and eluctant to accept the reporting requirements which would be necessary to permit public share issues. Existing markets for share equities are thin, and it has been a frequent experience of such institutions as the IFC and the DEG to encounter serious difficulties in the resale of their equity. The lack of the information systems needed to support equity markets, and the small number of participants in them, can result in extreme price instability.

On the other hand, support for the development of capital markets in some of the more advanced LDCs may be productive. AID provided assistance during the early 1960s in the organization of the Korean Stock Exchange, an early instance of success. More recently, AID/PRE has participated in the initial capitalization of a new venture capital firm for the Caribbean and has been active in providing technical assistance and advisors in securities market development.

As in the case of lending institutions, assistance in the development of LDC equity markets and institutions will require a combination of approaches -- policy analysis and reform, technical assistance, technology transfer, training, and financial support.

The intrinsic complementarity of these approaches and the need to focus on domestic resource mobilization through the development of more flexible and efficient domestic financial systems in LDCs are the essential lessons of the past. Without these emphases, the effectiveness of external resource transfers channeled through LDC financial sectors is unlikely to be great.

External Resource Transfers

Development agencies are active in transferring external resources to expand the supply of capital in LDCs through four basic mechanisms:

1. Direct lending to individual firms

2. Development and support of public financial institutions

3. Development and support of private financial institutions

4. Direct investment in individual firms

AID PRE has undertaken a small number of direct lending operations involving individual enterprises. These include the Antigua Shrimpery, Leather Industries of Kenya, and Sayyed Machinery Ltd. in Pakistan. These experiences have not been evaluated yet. However, it is unlikely that direct lending to enterprises will develop into a major area of AID activity. AID lacks and could not effectively develop the specialized industry expertise that would be needed to deal with firms on a one-to-one basis, nor is this a cost-effective approach to the management of AID resources.

AID, both because of statutory limitations and because of the specialized labor-intensity of such activities, does not currently engage in direct investment in individual firms. Other donor institutions such as the IFC, CDC, and DEG are active in this area. AID has preferred in the past and is likely to continue to favor indirect action, supporting other institutions such as the Latin American Agribusiness Development Corporation (LAAD) on a regional basis and individual DFCs, venture capital companies, or investment banks in host countries to perform these functions. The desirability of institution building, management efficiencies, and the restrictions of a bilateral, government-to-government relationship argue persuasively in favor of AID's continuation of its wholesaling approach to resource transfer for investment.

The question for AID then becomes one of evaluating the relative merits of supporting publicly owned versus privately owned financial intermediaries in developing countries.

Such an evaluation cannot be based a priori on efficiency considerations alone. In principle, both kinds of institutions can operate efficiently in mobilizing and allocating investment capital. For example, the experience of AID with two industrial development finance companies in Ecuador, one public and one private, indicated that both have been effective and successful institutions. The PPC Special Study of these institutions indicates that while the public institution has been required by Government to acquire equity in and provide loans to a number of public enterprises that were in financial trouble, the central Government has also provided capital subscriptions for this purpose and the commercial portion of this institution's portfolio has not been significantly affected. Administrative costs of the private institution are lower than those of the public one, but this is compensated for by a slightly lower quality portfolio and a higher percentage of overdues. The private institution has diversified its lending into a larger number of sectors than the public and appears to have been more willing to undertake risks.

Both are strong institutions, however, thanks largely to the quality of their management, and were judged likely to be able to weather the financial crisis which Ecuador is now undergoing, with every prospect of continued service and growth into the future. These institutions are discussed in greater detail in Appendix B. Also discussed there is the case of the Private Development

Corporation of the Philippines, a recipient of AID startup support in the early 1960s, privately owned and quite successful.

On the downside, numerous examples of both public and private sector failures could easily be cited.

It would appear, then, that an assessment of the quality of available financial institutions and their capabilities in specific credit or equity markets should be the initial basis for the selection of AID delivery mechanisms in LDC financial sectors.

If high-quality institutions exist in both the public and the private sectors, then considerations of balance, of potential replicability, and of preserving competition in the course of future market expansion may argue in favor of the private sector alternative.

4.2.3 Expanding Contacts With International Markets

LDC private enterprise also requires greater contacts with and access to international markets to earn foreign exchange, encourage technology transfer, raise product quality standards, maintain state-of-the-art technical knowledge, and obtain crucial equity financing. There are two principal types of action programs that can help the LDC private sector attain these goals: export promotion and investment promotion.

Export Promotion

Several donors are active in this area, including the World Bank through the DFCs, the United Nations by way of the U.N. International Trade Center, the CFTC, and the U.S., British, Canadian, and West German Government aid programs. Assistance is provided in a range of areas and generally takes the form of technical advice and promotional services. It may be provided in both the developed countries and the LDCs. Two donor approaches predominate: (1) a developed country government establishes and operates its own program to help LDC producers sell into its own domestic market, and (2) donors help LDCs to establish local institutional capacity to mount their own export promotion efforts.

Developed Country Government Programs. These programs have several common features: market research, careful LDC product selection, brokering of buyer-seller contacts, and the use of organized trade meetings as the vehicle for promoting business developmet.

The West German Government, for example, focuses on trade fairs as the best vehicle for promoting LDC products to potential German and other EEC buyers. To begin with, the GTZ identifies LDC companies with products likely to be marketable within the EEC. This company and product identification work is often done by the 30 advisers abroad working under the Business Cooperation program who, among other things, are responsible for promoting LDC exports. The GTZ also sends experts to the LDCs to help select sample products that meet EEC quality standards. Thereafter, the GTZ promotes the attendance of a selected number of participants by offering a modest subsidy toward the stall rent at the fair. At the fair itself the GTZ helps to put LDC producers into contact with buyers.

The CFTC has a similar approach, which begins with an intensive research effort in both the supplying country and the target country or regional market. Buyer-seller meets are arranged, usually in the buyer countries, which provide sellers the opportunity to present a range of carefully selected and adapted products to potential buyers. The objective is to obtain orders on the spot and, ultimately, to develop long-term business relationships. Through followup action, CFTC facilitates and encourages the maintenance of contacts and orders. Contact Promotion Programmes, a variation of the buyer-seller meet, are also organized. These efforts, which normally deal with a more limited product range, are small, highly concentrated attempts to put sellers in direct contact with buyers, again after careful research in both importing and exporting countries.

The key to the described approach is that the donor agency assumes direct responsibility for organizing the effort, rather than trying to build up LDC competence to do it for themselves.

Government and Other LDC Programs. Within the LDCs themselves, assistance may be provided to official government export promotion agencies or similar programs in DFCs and other institutions to help formulate and institutionalize an export development effort. Technical expertise may be offered to develop and adapt specific products. Market studies may be financed or conducted to determine likely market outlets for specific products. The World Bank and the United Nations are the most active donors pursuing this alternate approach. World Bank assistance has been focused on assisting DFCs to develop export promotion units and departments. The United Nations, through the ITC, for example, focuses on the establishment of trade promotion organizations in the LDCs. In addition to assisting the formulation of national trade policy and general organization development, ITC programs embrace a host of functional activities, including development of a trade information system; preparation of market research studies; marketing and market development exercises; participation in trade fairs and exhibitions; organization of trade missions; development of overseas commercial representation; product adaptation; design and packaging; publicity and publications; trade facilitation; provision of advisory services to exporters; export finance and credit insurance; and promotion of specific products.

AID has also been active to some degree in this area. PRE has recently funded an export finance and trading project in the Dominican Republic. AID has also supported the development of the Commercial Agricultural Trading Company (CATCO), a private company promoting regional marketing of agricultural produce in the Caribbean area.

From the successes recorded by the CFTC and German programs, it would seem that in the short run direct intervention by developed countries in LDC export promotion efforts is required. Still, LDC institutional capacity should be developed concurrently to support the long-term trade requirements of the developing countries. To accomplish this, donors should look beyond the development of LDC government capacity to the encouragement of such private mechanisms as export trading companies for the promotion of exports.

Investment Promotion

The process of promoting foreign investment in the LDCs is a complex and protracted one that requires a network of mutually reinforcing institutions and activities in both the developed countries and the LDCs. As in the case of export promotion, donors have approached the subject in two ways. First, some country or bilateral donors have set up their own programs to promote investment by their nationals in specific LDCs. These donors include specifically the Germans, French, and British. Such programs involve the positioning of permanent staff both in the LDCs and in the donor countries. Staff abroad seek out project opportunities, and staff at home locate investment partners. The IFC follows the same approach through a combination of locating some staff abroad and engaging home office staff in frequent travel. Because this approach is particularly oriented to mobilizing and using developed country resources to promote foreign investment, it will be treated in Section 4.4. A second approach, described below, focuses on helping the LDCs to develop their own institutional capability to attract foreign investment.

Many donors, particularly multilateral, have been active in assisting LDC investment promotion efforts. In some cases technical assistance has been provided to local investment promotion agencies to help them institutionalize their promotion program. The DEG provided advisors to the Tunisian Investment Promotion Agency for several years to help them develop their promotional programs and, more specifically, to promote projects with potential German investors. This model has been followed more generally by the German Business Cooperation program which now provides consultants to work within investment promotion agencies and programs in 22 countries to help broker project possibilities with investors and improve institutional capacity. The CFTC has also provided advice on investment policy and has assisted agencies to improve their operating procedures. In recent years, CFTC has begun to organize within member LDCs investment workshops aimed at bringing project possibilities together with interested foreign investors.

The most extensive LDC-oriented investment promotion program is that run by the U.N. Industrial Development Organization (UNIDO), the Investment Cooperative Program (ICP). Established in 1975, the purpose of the program is to promote industrial investment projects in the LDCs. It does this by acting as a "marriage bureau" bringing together developed country investors and LDC entrepreneurs and thus generally promoting investment flows from north to south. Although it has no stated preference for either private or public sector projects in the LDCs, it is clear in its focus on promoting private foreign investment in the LDCs.

At its main office in Vienna, the IPC maintains an Investment Promotion Information System comprising four data banks. The Project File lists some 750 current project opportunities proposed by LDC sponsors. The Investor File contains offers of participation from public and private enterprises around the world. The Bank File contains information on potential sources of finance from national, regional, and international development finance institutions. The Institution File is a directory of LDC institutions likely to be engaged in the creation of new industrial projects.

ICP has also established UNIDO Investment Promotion Service (IPS) offices in major cities of the industrialized countries. These offices are meant to perform investment brokerage functions between the host country and any country represented within the office. They are staffed by host country nationals and LDC nationals whose task is to promote the desired investment linkages. These service offices, which provide LDCs with an alternative to setting up a costly individual investment promotion office, also operate as a training ground for LDC nationals, most of whom have little previous experience in investment promotion work.

PRE has collaborated with UNIDO on its IPS programs in the Caribbean, which aims to train Caribbean nationals in techniques of investment promotion. PRE has also assisted institution-building efforts in this field in Sri Lanka, Thailand, and Panama through the Investment Council of Panama.

There are indications that the UNIDO program has fallen considerably short of expectations; in particular, that its data banks are not as effective as organizers had hoped and that the training program is inadequate to the task of institutionalizing the investment promotion process in the LDCs. Experience to date, therefore, raises a question whether an institution-building effort in LDC investment promotion is per se adequate in the short run. The relative merits of programs in which the developed countries take the initiative to promote investment in LDCs are discussed in Section 4.4.

4.2.4 Improving Technology and Management

Two recurring themes in assistance to LDC private sectors are the need to improve the generation and transfer of technology for the use of such firms and the value of improving management and technical skills through training and technical assistance. AID programs in these areas have been a major element of AID assistance to the private sector, and 21 of the 36 evaluations of private sector projects identified training, technical assistance, or management as significant project components. Recent examples of such projects include the following:

-- Private Sector Employment-Related Training in Honduras (planned)

-- Management Assistance to Rural Traders in Malawi

-- Technical Consultations and Training in Jamaica

-- Kenya Commercial Bank

Other donors have also directed attention to these areas, using approaches similar to those used by AID as well as others that seek to link technology development in their own private sectors with applications overseas. The French agency, ANVAR, the German DEG, and the Canadian CIDA, for example, have programs that support the testing of developed country technologies in LDCs. These programs are discussed more extensively in Section 4.4.

AID and other donor assistance in this area has made use of three broad strategies:

1. Technology development and transfer

2. Provision of technical assistance and training

3. Development of technical assistance and training institutions, including support to LDC business and industry associations

A fourth and related area of activity -- but one that cannot be considered project assistance -- is the implementation of training, staff development, and management reform programs aimed at improving donor agency and host government ability to assist the LDC private sector.

AID and other donor experience in these areas strongly supports the view that they are appropriate areas for donor assistance and meet a need that the local private sector cannot readily provide for itself. Nonetheless, the project evaluations and other sources reviewed suggest ways in which donor assistance can be made more effective and identify some approaches that have generally been less successful.

Technology Development and Transfer

AID support of technological progress within the overseas private sector has used two broad strategies:

1. Development of technologies specifically intended for use in LDCs (e.g., the support to Appropriate Technology International [ATI], the Small-Scale Agricultural Activities Project in Egypt, and the Seed Program and Industry Development)
2. Transfer of existing technologies, possibly with modification, to promote their application to developing country enterprises

(e.g., the Indonesian Industrial Extension of Agricultural Machinery Project, the PRE-supported HEALTHLink and Leather Industries of Kenya projects; National Housing Corporation Secondary Towns in Kenya; and the ALCOSA/LAAD activity in Guatemala)

Of these two approaches, the "transfer" approach appears to have been the most successful overall, because it is more strongly connected to specific business opportunities and verified needs in the private sector. The ATI evaluation, for example, comments that ATI has had problems in moving technologies into actual manufacture, except when they have worked directly with a small manufacturer from the early stages of the activity. The institute formed a Business and Technology Department in 1981 in a move to increase its use of the "transfer" strategy. The evaluation of the Small-Scale Agricultural Activities Project in Egypt criticized the project's use of ministry workshops as a main factor behind the failure to develop technologies that later went into production.

A second finding is that involvement of the U.S. or other developed country private sector promotes the technology transfer process. For example, the Leather Industries of Kenya Project is utilizing a Belgian leather goods firm as the supplier of processing technology.

The Canadian CIDA, the German DEG, and the French ANVAR have recently begun experimental programs to support the direct firm-to-firm transfer of technologies between their private sectors and those in the developing world. These programs are similar in design to a newly initiated PRE program, Commercialization of Technology, which provides funding for both sale of technology and joint ventures involving technology transfer. The German experience with this approach has been disappointing, and DEG is giving serious consideration to cancelling it, but the French and Canadian programs appear to be attracting more interest from their respective private sectors. Although it is too early to judge the success of this approach, the different experiences of the other donors should clearly be examined for lessons applicable to PRE's program and to other potential country programs.

Several of the evaluations also underlined the desirability of linking credit to technology transfer. The Bolivian Savings and Loan System project, for example, uses the credit institution itself as the agency promoting use of improved technology for water and sewerage systems. However, credit is not a prerequisite to success in technology transfer, as shown by the experience of the International Rice Research Institute (IRRI) in Indonesia, documented in a PPC Special Study.

The experience of the IRRI project highlights a fourth general finding: large firms play a role in transferring technology to smaller firms. In the Indonesian case, large firms were given special priority by IRRI in the first stages of the technology transfer process. Although large firms were often the first to begin production of the new machinery, ultimately the smaller firms were the ones to accept the technology as a major focus of their business.

Provision of Technical Assistance and Training

Technical assistance and training have been provided in two main areas, other than technology transfer:

- Management, broadly defined (e.g., the PfP projects in Kenya and Upper Volta; the Tunisia School of Management project; and many of the projects involving development finance corporations, such as the Entente Fund Africa Enterprises Program and the Kenya Commercial Bank project)

- Vocational skills (e.g., Basic Skills Training in Jamaica, Vocational Training in Jordan, and Industrial and Commercial Job Training for Women in Morocco)

Of the two approaches, management training and related technical assistance have been by far the more important activities, and the more successful. An important finding in both areas is that public sector entities have a legitimate and important role in training for private enterprise, but are perhaps less successful in providing technical assistance.

A second important conclusion applicable to both is that the value of long-term training has been underemphasized. Both the Thai seed experience and the special study on Korea emphasized the role that individuals who received long-term training in the United States later played in the development of the private sector. AID's direct linkage of participant training to specific projects with a limited time frame has led to a gradual decline in long-term training, which should be reversed. The pervasiveness of this overly narrow attitude is indicated by the evaluation of the centrally funded Seed Program and Industry Development project, which quotes the university contractor as believing that "AID does not fund persons for training from the private sector."

With regard to vocational training, the experience suggests that vocational skills training helps individuals, but does not expand private sector activity, at least in the short run. The evaluations provide little information on the long-run effects of vocational skills upgrading, but there is intriguing, if anecdotal, evidence that skills upgrading can ultimately encourage the formation of new businesses. For example, one of the most dynamic firms encountered in the IRRI/Indonesia case study was headed by an individual who had benefited from skills training in government workshops.

The experience of the other donors -- particularly the German program -- points up the benefit of utilizing developed country firms for technical skills training. A report on World Bank private sector activity recommends that the Bank make greater use of this potential by requiring suppliers to provide in-plant training for individuals from the developing countries.{16}

Recent project experience reemphasizes the widespread belief that management training for entrepreneurs is extremely valuable, especially when it is directly linked to the needs of their businesses and provides techniques that are readily applicable to their firms. Two very different approaches have characterized recent project assistance in this area:

1. Formal training, ranging from 6-week courses in the Lesotho Opportunities Industrialization Center Program to degree-granting programs such as in the Tunisia School of Management and Central America's INCAE

2. Informal advice in association with credit, an approach used most commonly by PVOs and DFCs

A major barrier encountered in formal training is the difficulty of reaching active entrepreneurs, in view of their inability to leave their enterprises for extended periods. In the Lesotho case, this resulted in a preponderance of retailers over individuals operating manufacturing enterprises. This problem suggests that training be directed to middle management and future management. By "future management," we mean individuals who are likely to become entrepreneurs in the future. The strong demand encountered for the graduates of the Tunisian Schools of Management and the evidence that some graduates are already starting their own businesses supports the value of this approach.

AID experience underscores the close connection between credit and management assistance. Nearly all of the credit projects reviewed include a component offering management assistance to borrowers. The evaluation of the PfP/Kenya project, for example, quotes project staff as saying that technical assistance without credit is like an "unfertilized egg." At the same time, project experience indicates that one-on-one management advice is extremely costly. More attention is needed to find ways that this assistance can be supported and made sustainable, whether the source of credit is a PVO or a large financial institution. Recent programming reveals the importance of the problem.

1. As has long been established with regard to agricultural extension, linking technical assistance with the provision of credit is helpful but linking it with the collection of credit creates administrative and substantive problems. The experience of PfP/Kenya, for example, suggests that advisers should limit their involvement to assisting businessmen to obtain loans from other institutions, leaving the loan decision itself and credit collection to others.

2. In the case of the newly funded Royal Bank of Jamaica Guarantee Facility, it proved necessary to allow a special 2- to 4.5-percent commission, largely to cover the additional cost of providing technical assistance to borrowers.

3. The cost of technical advice was cited as a factor contributing to the limited outreach of PVO-administered credit programs in Guatemala (Women in Development), Honduras (IIDI/IDH), and Upper Volta (Rural Enterprises Development).

4. The cost of bank-provided technical assistance to small borrowers -- already a relatively costly clientele -- places an extra burden on DFCs that only the best managed are able to handle. For this reason, commercial banks have only limited interest in establishing such services internally. It will be instructive at a later date to compare PRE's approach of encouraging such services to the World Bank's approach of encouraging lending institutions to promote use of local sources of management and accounting expertise by their clientele.

5. Experience with government-owned entities as sources of technical assistance for private firms has been disappointing, as witness the apparently abortive effort of the Training for Small Business project in Cameroon, which tried to establish such a program in a public university.

6. The lure of credit has been an important factor attracting businessmen to training and technical assistance sources, whether because they perceive they must accept one to get the other or because they feel the technical assistance will help them meet loan requirements (e.g., presentable ledgers).

The overall conclusion with regard to both training and technical assistance in vocational and management skills is that they do not create new enterprises or jobs in the short run but are a major, if indirect source of future growth. Baker's study of obstacles to private sector activity in Africa emphasizes the need to actively promote entrepreneurship.{17} The transfer of the skills needed by, in her words, "aspiring entrepreneurs" is an important channel for such action. This finding must remain tentative in the absence of a more thorough analysis of the sources of entrepreneurship.

Development of Technical Assistance and Training Institutions

Despite the recent emphasis given to institution building, the private sector, and technology transfer, AID experience with the intersection of these three concepts -- development of training and technical assistance institutions for the private sector -- is relatively limited. Programs fall into three categories:

1. Linkages with developed country trade associations, such as the centrally funded Commercial Seed Industry Development project

2. Support to indigenous associations, such as the Togo Credit Union Movement project

3. Development of technical assistance and training institutions in the LDCs, particularly local PVOs and semi-public training institutions, such as the Jamaican National Development Foundation project

The principal finding in this area is that development of institutions to support the private sector is a useful strategy and should be expanded.

At the same time, the lack of truly private institutions in some cases -- notably in Africa -- presents a serious barrier to broader programming in this area. Support to government-owned institutions with similar functions is probably counterproductive, given their disappointing experience. West German assistance programs have experimented with efforts to "twin" German trade associations with similar groups in West Africa, but the LDC associations have generally proven too closely linked to the government to win the confidence of their members.

A second caveat suggested by experience is the danger of encouraging such groups to become overly politicized. Although democracies need and encourage private associations that actively represent the interests of their members, other forms of government may view such groups as a threat and take action to slow their expansion on both political and nonpolitical fronts. A tragic example is the assassination of cooperative leaders involved in an AID-funded program in Central America.

Experience with institutional development programs suggests two requirements deserving greater attention in their design: the need for a long-term commitment and for action to assure continued funding. The Togo credit union evaluation, for example, noted that 8 to 10 years of continued assistance had proven necessary to build permanent institutional capacity. Similar periods are also cited for the development of private associations in the Thai seed industry and elsewhere.

With regard to funding, the need to provide assistance to indigenous PVOs in fund-raising and to find sustainable sources of government funding that do not threaten the groups' autonomy was stressed in the evaluations of the IIDI program in Honduras and the PfP program in Kenya. Although both programs have established new indigenous PVO subsidiaries with useful programs of assistance to the local private sector, neither has been able to establish adequate systems within the PVOs to ensure future financial viability.

The experience with the Industry Council for Development (an association of U.S. and European industries, including agribusinesses) underscores the untapped potential represented by U.S. private sector associations. An evaluation of theprogram found that this organization has successfully provided technical assistance, training, and other support to private seed industries in a wide range of countries. The association has been particularly effective in promoting policy change, by focusing specific attention on policies that limit the expansion of indigenous seed industries. The association has successfully capitalized on its perceived independence from individual U.S.Companies and from the U.S. Government to provide technical assistance to host country governments on policy and legislation.

Development of Capacity for Private Sector Development in Host Country Governments and Donor Agencies
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Given the importance of action by the donors and the host governments in promoting (or retarding) private sector development, it is surprising that the review of donor private sector programs turned up very little activity designeda to build capacity in these two types of organizations. PRE has only recently initiated such a training program for AID, and only one donor -- the IFC -- has accumulated experience with internal training programs specifically directed to building private enterprise-related skills. None of the donors appears to be undertaking programs to build capacity in host country governments to understand, support, or promote private sector activity. The only exception is the limited experience with offshore investment promotion authorities, discussed in Section 4.4 below.

Despite the paucity of programming in this area, the lack of donor and host government capacity is recognized as a deterrent to successful assistance for private sector development. Staff working on enterprise development in several donor agencies commented that the lack of personnel with strong private sector skills (particularly in finance, trade, and marketing) is a serious barrier to the design and implementation of private sector activities.

In some developing country governments, basic attitudes toward the private sector and its potential for positive contribution to the development process must be overcome before it is realistic to expect government action in support of the private sector. The Baker report on obstacles to private sector activity in Africa emphasizes the role that governments' mistrust and misunderstanding of the private sector play in the creation of a legal and regulatory climate that restricts private sector growth.

Limited progress toward removing this major barrier to private development has been made through the policy reform activities described above. Recent World Bank and other donor studies of the success of market-oriented economies have been influential in changing the thinking of both host governments and the donors themselves. Nonetheless, additional action in this area is clearly a priority.

The following actions are indicative of possible areas for expanded programming to build host country and donor capacity in private sector development:

-- Training for donor personnel. Private sector programming is a relatively major departure from previous programming. Donor personnel need explicit assistance to acquire the skills necessary.

-- Expanded exchange with the U.S. private sector. More aggressive recruiting of personnel with extensive private sector experience is a short-term solution to the lack of expertise in critical private sector-related skills, but the experience of the DEG and others indicates that it is extremely difficult to retain such personnel, given the operating style, salary levels, and existing financial constraints of the donors. Consequently, imaginative approaches to increasing contact with the U.S. private sector by existing staff are needed, such as creation of a joint career corps for the private sector parallel to that recently created for academic personnel and approval of "mid-career internships" in the private sector as an alternative to academic long-term training.

-- Development of incentive systems that promote AID contact with the LDC private sector. Whereas decades of development assistance have built up "donor receptors" in the host government, the indigenous private sector does not seek contact with AID. Systems and procedures that encourage AID officers to establish such contact are therefore needed to build staff understanding and specific knowledge of the host country private sector, without which sound program design and implementation is virtually impossible. Systematic analysis of private sector needs using a constraints analysis approach is an example of a measures that would encourage greater contact and understanding.

-- Expanded supply of information on the private sector's role in development and barriers to private sector effectiveness. Existing analysis is strongly indicative of the crucial function the private sector plays in accelerating development and the equally critical role that government policy plays in promoting or restricting private activity. These general findings need to be confirmed on a region-by-region basis in order to fuel expanded dialogue with the host governments and identify the specific barriers that donor assistance should be targeted toward removing.

{16}Keith Marsden, Cooperation Between the World Bank and Private Enterprise in the Industrial Sector," (International Bank for Reconstruction and Development, July 1984).

{17}Pauline H. Baker, Obstacles to Private Sector Activities in Africa (Battelle Memorial Institute, January 1983).

4.3 Project Assistance Through Private Organizations

A third area of emphasis within the Private Sector Initiative has been the increased use of indigenous private sector organizations in the implementation of development projects. Reliance on private delivery mechanisms has extended beyond cases where the private sector itself is the target (e.g., small enterprise development) to include delivery of goods and services traditionally considered public sector activities (e.g., health and agricultural extension).

This approach builds on the longstanding use of donor country private institutions to support project implementation. Private construction and consulting firms, PVOs and cooperative organizations, and private universities have cooperated in AID projects since the

Agency's inception.

The use of developing country private sector mechanisms has taken four forms:

1. Increased reliance on markets, rather than planning, to make resource allocation decisions

2. Promotion of private sector suppliers of goods and services as an alternative to government supply

3. Support of expanded contracting by the host country government for the delivery of goods and services financed by it

4. Assistance to indigenous private sector nonprofit organizations, including cooperatives, private voluntary organizations, and business associations

In practice, these approaches are complementary rather than conflicting, and several may be combined in a single project. For example, a livestock development project may support decontrol of livestock product prices, assist an association of livestock producers, provide credit to private feed and grain suppliers, and assist the government-managed animal health service to expand its use of existing veterinary services in a vaccination program. Often these approaches are combined with public sector approaches in a single project.

The review of projects initiated since FY 1981 identified 66 projects directly involving private sector organizations in project implementation, out of a total of 211 private sector projects identified. An additional 25 used a mix of both public and private channels.

This estimate undoubtedly understates the use of these approaches in the total AID portfolio, because the nature of project delivery mechanisms cannot always be determined from the summary documents used in this review.

Interviews with donor personnel make it evident that they have given much less emphasis than AID to using private delivery mechanisms. Some of the donors -- notably the British ODA -- are assigning this approach greater emphasis in the design of future programming. Others -- notably the French--have focused their private sector initiative almost entirely on other approaches, especially support to the development of indigenous enterprises and greater involvement of their own private sector in development.

4.3.1 Why Use Private Delivery Mechanisms?

Expanded use of private delivery mechanisms has been motivated by both practical and programmatic considerations and offers five main advantages:

1. Economic efficiency. By harnessing the market's ability to allocate resources efficiently, market-based strategies replace reliance on cumbersome and inaccurate planning mechanisms, reducing misallocation of resources.

2. "Practical" efficiency. Private sector providers must keep their costs within their receipts and are not bound by many of the cost-increasing restrictions that hamper public delivery mechanisms. Both factors tend to lower costs for private sector providers relative to their public counterparts.

3. Flexibility. Private sector organizations are more flexible than public entities and respond more readily. providers may facilitate adjustment of the program by permitting the government to shift from one existing provider to another. For example, a pilot program to provide health services through existing retail outlets in one region can be expanded to other regions where similar outlets exist, whereas a program dependent on government offices may require that new units be established in order to expand into a new region.

4. Reduced impact on public sector recurrent costs. If private providers can produce the goods or services desired in a profitable manner without subsidies, then the drain on governmental operating budgets can be reduced. This advantage applies only to the use of private suppliers as an alternative to public supply of the same good, not to use of private sources via contracting. The latter may reduce costs if private contractors are less expensive than comparable public entities, but the impact is unlikely to be dramatic.

5. Reduced government intervention in the market. Encouraging private sector provision, whether directly for profit or through contracting, helps to maintain a balance between public and private sector involvement in the market. This balance is regarded by some as critical to establishing a pluralistic economy and avoiding overconcentration of economic and political power. It also limits the incentive for the government to use its power to shift market-determined outcomes towards command-determined outcomes in ways that favor government enterprises (e.g., establishing price controls on industrial inputs in order to reduce the costs of government-owned industries).

4.3.2 Limits to the Use of Private Mechanisms

There are very real advantages to private sector delivery and equally real opportunities to expand their use, but there are also major limitations and problems associated with them. In some cases, imagination and creativity can overcome these limits, but in others a legitimate public interest requires continued public sector involvement, whether as direct provider or as a regulatory mechanism.

When considering whether provision of a particular product or service belongs in the private sector, each case must be evaluated on its own terms. Hard-and-fast rules should be avoided. Well-known theoretical rationales exist for public-sector activity in policy setting, infrastructure, education, and research. Yet, as discussed below, each of these functions may well be performed more effectively with the support of private, for-profit firms. In other cases, circumstances may require public involvement in the provision of a product, such as fertilizer, that would normally be supplied wholly by private firms.

The major limitations to private delivery mechanisms fall into six categories:

1. Limited profitability. Not all goods and services can be provided at a profit. Society must then either provide the goods or service directly or subsidize private providers to do so. Before accepting nonprofitability as a rationale for public sector provision, however, it is necessary to determine why the activity is not profitable and whether this situation can be corrected. In developing countries, government intervention in the market is one of the most frequent causes of unprofitability. In other cases, the factor that limits profitability (e.g., high transport cost) may be amenable to government action (such as by expanding the road network).

2. Impact on government_operations. Profitable and unprofitable activities have often been "packaged" together in a single public institution. For example, subsidized credit is combined with the sale of fertilizer to keep the public sector agricultural bank in Egypt financially viable. Many DFCs combine credit to larger, more lucrative clients with credit to small, high-cost clients. When private sector entities are permitted to operate in these markets, they will naturally operate only in the profitable submarkets, with the result that unprofitable submarkets are underserved (in some sense) or that public providers serving these markets inevitably lose money. Many of the evaluations of DFC activities suggest this is a problem.

3. Equity and distribution concerns. Allocating resources in an economically efficient manner may not lead to a "socially optimum" result in the long-run economic and social interest of the country as a whole. For example, a free market in health services will result in poor, isolated rural individuals receiving much less health care than wealthy, urban dwellers. Whether the government should intervene to change this outcome is a question to which there is no "correct" answer.

4. Absence or limitation of private sector activity. Private sector activity in many developing countries has "gaps" where there are few if any private providers. For example, there may be no firms engaged in the export of fresh fruits and vegetables, even

though this activity appears to be profitable. Again, the key question is why. Close examination of the specific situation is required to determine (a) whether there is in fact more private activity than believed, (b) whether the activity in question is in fact profitable, (c) why the private sector is not responding to the opportunity, and (d) what should be done. Experience suggests that project designers too often answer the last two questions before they have answered the first two, with unfortunate results.

5. Oligopoly and monopoly. Noncompetitive markets are common in the developing world (for reasons too complex to discuss here). Where such market problems exist -- whether on the buyer or the producer side -- free market operation will not result in an economically efficient allocation of resources. Again, the question is why is the market noncompetitive and what should be done about it. Noncompetitive market conditions may arise because the market involved is still in the early stages of its development (the first person to introduce a new good always starts as a monopoly), because of the structure of the market for the product (e.g., certain utilities for which a single supplier with monopoly power enjoys an unassailable competitive advantage), because government action has artificially limited entry into the market, or because lack of transport and other services makes it unprofitable for private providers to enter the market unless they can maintain monopoly power. It is natural for the private firm to try to acquire a monopoly; it is the role of government to prevent it from doing so or to regulate it if it cannot be prevented.

6. Innovation myopia. Whereas the private sector is often and rightfully praised for its innovativeness, especially in comparison to the public sector, experience suggests that the private sector responds much more readily to "nearby" opportunities than to those that require a major shift into a new type of business. For example, seed dealers in Thailand were hesitant to enter into the production of hybrid seed until the Government demonstrated that this activity was profitable.

These limitations provide both opportunities and warning signs for AID. They indicate possible intervention points, but they also underscore the need to know the market structure before attempting to use it for development. The key concern is that project designers not fall into the trap of using a double standard that rules out potential private sector delivery mechanisms because the private providers are flawed, while accepting equally serious imperfections on the part of alternative, public sector providers.

4.3.3 The Role of AID and Other Donors in Expanding the Use of Private Delivery Mechanisms

Collectively, AID and the other donors have a major impact on the division of responsibility between private and public sector providers of development goods and services. This impact is expressed through four channels:

1. Policy dialogue and other discussions with the government regarding the desirability of expanding government delivery

2. Allocation of financial resources to support expanded use of private sector delivery mechanisms

3. Identification and removal of barriers preventing the private sector from expanding in profitable areas, thus reducing the rationale for government provision

4. Refusal to fund expansions of public sector activity in areas where private provision would be profitable

Of these four, the last is perhaps the most important. The very real limitations to public sector resources for investment and recurrent costs, which have reached crisis proportions in many countries, effectively limit the ability of LDC governments to expand their activities, whatever their rhetoric. Donor support has encouraged LDC governments to enter areas of action -- such as provision of agricultural inputs -- that now can be seen as a misallocation of government resources and a barrier to private sector expansion on a sound financial footing.

While donors are expanding programs explicitly directed to private sector development, the major share of donor resources will continue togo toward social services and other developmental programs where support to the nonagricultural private sector is not the main purpose. By channeling a significant portion of these resources through private sector delivery mechanisms, the donors have the potential to provide indirect assistance to the private sector far in excess of the "private sector" portfolio.

Conversely, donor support of public delivery where private channels are feasible and preferable can do serious damage to the private sector and effectively cancel out direct assistance. For example, if a $20-million agricultural project supports public sector production and sale of hybrid seeds where private provision is entirely possible, it may prevent or greatly delay the development of a private seed industry. Existence of a $2-million credit line for rural traders does not "make up for" the damage done to the private sector.

4.3.4 Areas Where Use of Private Delivery Mechanisms Can Be Expanded

The Agency's increased emphasis on private alternatives to public provision of goods and services has combined with a growing recognition within the development profession that public provision has proven disappointing. This view has produced a greater openness toward alternative delivery strategies such as the following:

-- Housing and infrastructure projects, such as the Low-Cost Shelter Project in Bolivia and the Home Improvement Project in Belize

-- A large number of agricultural credit, input, and marketing projects using private institutions, such as the Fertilizer Distribution Improvement II Project in Bangladesh and the Management Assistance to Rural Traders Project in Malawi

-- Health care and education projects, such as PRE's HEALTHLink in Thailand and Indonesia and the Basic Skills Training Project in Jamaica

-- Enterprise_development projects, including the Private Investment Corporation Project in Costa Rica and PRE's Siam Commercial Bank Project in Thailand

-- Projects in support of policy reform such as the Honduran Managers Association (GEMAH) Project

Despite this promising beginning, the shift toward greater use of private delivery mechanisms is still in its early stages. The following sections suggest some promising areas for exploration, but private sector delivery is clearly an area where future programming is hampered by a lack of concrete information on existing private sector activity, especially in the rural areas.

Infrastructure and Housing

Most governments routinely use private sector contractors for construction of infrastructure, and AID infrastructure projects should encourage this practice. Two possible areas for expanded programming are (1) government capacity to select and monitor contractors and (2) efforts to support contractor efficiency, including both access to technology and equipment and the contractors' internal management and accounting systems. In housing, considerable progress has been made with use of private contractors to construct low-cost housing, as evidenced by the positive findings of the Kenya National Housing Corporation project evaluation. Additional attention should be given to the transfer of low-cost housing technologies and development of financing mechanisms permitting private builders to serve the low- and middle-income market with a minimum of government intermediation.

A second area where expanded support to private providers is feasible is in what may be termed "quasi-infrastructure." Roads, clearly, are a public sector function, but roads cannot perform their function in the absence of truck-transport services, service stations, and other functions, most of which are well-suited to private, for-profit operation. Development of private trucking companies was a major factor in the successful maize marketing strategy of the North Shaba project in Zaire. Electrification may be provided by either public or private networks, but where electricity is not available, the same function can be performed reasonably well by private sale, rental, and service of small generators. The point is that private provision can play a critical role in bridging the gap between no service (and there-fore no industry to pay for such service) and sufficient demand to justify extension of the national grid.

Agricultural Support Services

Progress is being made toward privatization of agricultural inputs supply and marketing services, a task that is made more difficult by the existence of public sector institutions in many countries that received donor assistance in the past. With some exceptions, such as the rural traders project in Malawi, little attention has been given to developing the private trader network, in order to increase its effectiveness as a source of credit as well as inputs and marketing services. Programming in this area will require better information on current private activity, including the constraints to open competition in rural markets.

Although research and extension have generally been regarded as public sector functions, there is increasing (but as yet still anecdotal) evidence that small farmers in fact rely on private suppliers for information more heavily than on public sector extension services. It thus makes sense to seek out means by which private traders' provision of technological information to farmers can be supported and expanded. Research and development of technologies can also be transferred in part to the private sector, when the technology takes a form that permits ownership (and profit) to be preserved. For example, private companies have played an active role in development of improved seed varieties and agricultural chemicals in the developed countries, an experience which should be transferrable to developing country situations.

Health and Social Service Delivery

As with infrastructure and housing, the key to expanded use of private sector delivery mechanisms lies in dividing the service function into three parts: (1) goods and services that can be produced and sold at a profit (such as some contraceptives); (2) those that can be supplied by private providers but must be paid for in part by the public sector if the desired level and distribution of service provision is to be reached; and (3) those that must be supplied at least in part by the government, for ideological or pragmatic reasons (such as primary education). Ongoing experiments with private provision in nontraditional areas (such as the social marketing of contraceptives in Nepal and Bangladesh) should be monitored closely for guidance on future programming in this area.

Enterprise Development

Many of the programs to support private sector development have relied heavily on public sector delivery strategies, such as public sector DFCs and governmental investment promotion programs. Some projects are experimenting with private sector alternatives to support enterprise development, particularly through strengthening of trade associations and other nonprofit professional organizations. The Small- and Medium-Scale Enterprise Development Project in the Philippines is an example of this trend.

There have been fewer attempts to support development of the private sector businesses that provide the services necessary for rapid and sound expansion of business activity. This gap is somewhat puzzling. Perhaps it is because such enterprises -- accounting firms, corporate lawyers, advertising agencies, management consultants, and brokers of various types -- enjoy a somewhat mixed reputation in both the developed and developing world. Quality control is a special problem with such firms, since the value of their contribution is rarely directly measurable and technical standards are not always closely linked to commercial success. Again, it is important to ensure that a "double standard" is not being applied to private sector providers of these critical services, since most public sector programs in these areas are equally open to criticism.

Expanded support of such services deserves priority consideration, in view of the facilitating function that such businesses provide in speeding private development by increasing the profitability of other firms. This function, which parallels that of the private quasi-infrastructure firms discussed above, takes on critical importance because profitable opportunities are the key to rapid and dynamic private sector growth.

Support to Policy Reform

Opportunities for greater private sector involvement in policy formulation lie in three areas: (1) strenthening of organizations that speak for the private sector in policy forums; (2) expansion of private capacity to undertake policy analysis, whether the issues to be analyzed directly affect the private sector or not; and (3) replacement of centralized control by the market.

AID and other donor activity in the first area have begun to appear as part of private sector initiatives. In view of the politically sensitive nature of lobbying activities, however, this is clearly an area requiring caution. In some cases, the political activities of private sector organizations, such as manufacturers' associations, may be more effective if they are clearly independent from donor policy initiatives. Politicization of private organizations, such as cooperative unions, may also be detrimental to the long-run development of such institutions in societies where pluralistic participation in political activity is not fully accepted.

In view of the widely accepted difficulty of building public sector capacity for policy analysis (particularly the near-impossibility of retaining skilled analysts at government salaries), greater attention to private alternatives is clearly called for. Private sector institutions -- consultants, private universities, and think tanks -- are actively involved in policy analysis in the developed world, but efforts to promote policy reform in the developing world have to date paid little attention to the potential of such organizations in the developing world. Here again, the double standard is a problem, leading project designers to reject private sector institutions because of their weaknesses, while providing major assistance to equally weak public sector institutions.

Finally, and most controversially, some parts of the public policy function may be partially or completely replaced with a free (or quasi-free) market. No country allows key policy variables such as the exchange rate, interest rates, and food prices to be wholly determined by the free market without intervention. But few of the developed countries formally set these variables, either. Instead, there is an increasing tendency for these key values to be set in open markets, with governments intervening in the marketplace to alter market outcomes that they do not like. For example, until recent years foreign exchange rates were set by central governments. Now, however, it is the collective action of individual, largely private sector currency traders that set exchange rates for the hard currencies, with only occasional (and not always successful) intervention by the national treasuries.

This shift, which is still far from complete in the developed world, underscores the fundamental distinction between a reliance on planning to allocate resources and the alternative approach of relying on the market.

4.4 Mobilizing the Developed Country Private Sector for Development

The private sector in developed countries has traditionally been a major source of capital flows to the LDCs. It has also accounted for most technology transferred to the LDCs, either through direct investment or export trade. Private foreign investment in the LDCs has been dominated by large, multinational corporations which initiate projects in pursuit of global market strategies. Small- to medium-scale developed country industries have been only modestly active overseas. Because of trade links with former colonies and export-oriented economies, European countries have been more active in pursuing investments in the LDCs than has the United States.

Although foreign direct investment in the LDCs has been considerable in absolute terms, it has been modest relative both to the need and to the opportunity. Reasons for this include, among others, the hostility of many LDC governments to foreign investment, political instability in many LDC countries and regions, and the availability, particularly for U.S. manufacturers, of alternative investment opportunities within the United States, Canada, and other OECD countries.

Circumstances have evolved, however, and the environment for foreign direct investment has improved substantially. The contraction of international and commercial lending has created a need for other sources of finance. Many LDC governments have recognized the need for technical and managerial resources that only developed country private industry can provide. Legal and institutional obstacles to foreign investment are being eliminated, and LDCs are competing vigorously for the involvement of foreign industry. Conversely, greater numbers of industrialists in the developed countries, including SMEs, are finding domestic markets internationalized and LDC markets expanding. Consequently, many are beginning to recognize the need to consider manufacturing abroad. This latter fact opens up prospects for a vast new set of private resources to be engaged in development activities in the LDCs, particularly because SMEs in the developed countries hold much of the technology appropriate to LDC industrial needs. Also because of their smaller size, these SMEs may be better suited both operationally and organizationally to collaborate effectively with the typically smaller enterprises in the LDCs.

Despite these positive developments, many practical problems inhibit the expansion of foreign direct investment in the LDCs. SMEs in the developed countries, for example, generally lack the international experience and sophistication needed to explore and develop investment opportunities abroad. Many also lack sufficient capital to invest in a project of any significant size abroad and/or perceive the potential risk of doing so to be too great. Many simply do not have sufficient technical and managerial capability available to undertake on their own a long-term project involvement in an unfamiliar cultural and economic environment. Moreover, such projects usually involve the developed country enterprise in a technology transfer process of skill training and education that it has little experience and capability to mount or to manage.

Because of these many practical difficulties, it is unlikely that any great numbers of developed country private firms will on their own initiative participate in a project in an LDC in the near term, beyond those already established as multinationals. A significant expansion of private foreign investment will require the active stimulation of a variety of programs of assistance and institutional support. Many countries and donor agencies are already active in this field and some experience has been accumulated. But a much more extensive framework of institutional assistance is required to tap the vast potential resources available.

Assistance is required at the three principal stages of the investment process: preinvestment, investment, and postinvestment. Moreover, to the extent possible, such assistance must be tailored to meet the needs of SME in the developed countries or there can be little hope that the potential these firms represent can be tapped.

4.4.1 Preinvestment Assistance

As previously indicated, investment opportunities often develop in the normal course of established commercial linkages between developed country and LDC firms. Thus, a developed country exporter may decide to manufacture in an LDC as a way of protecting or expanding a local market, or the exporter may decide to set up production in an LDC from which raw materials can be purchased because it may reduce production costs. A fundamental aspect of any preinvestment support program must therefore be the promotion of trade between developed countries and LDCs.

Although the promotion of trade linkages will in due course generate investment projects, the process often yields results only over aprotracted period of time. It is also an approach which tends to leave the investment decision to the vagaries of an existing market and fails to recognize the possibilities of taking the initiative to create new markets or to better serve existing ones. The experience of the IFC, DEG, and other donors suggests that investment opportunities can be created and investment linkages developed both prior to the formation, and in the absence, of commercial linkages. To do so, however, requires a substantial institutional framework, a sustained commitment, and a willingness to invest considerable resources to achieve the objective. In short, it requires a full-scale investment promotion program active in both the developed countries and the LDCs.

Trade Promotion

Developed Country Exports. All the major donor countries have programs aimed at promoting trade between their manufacturers and the LDCs. All major bilateral aid programs, for example, tie the purchase of goods and equipment bought with their assistance to their own suppliers. Apart from their aid programs, these countries all have other government programs that assist their exporters to develop export markets in the LDCs.

The export promotion programs typically found in the major donor countries include the following elements:

-- Loan and loan guaranty programs provide both medium- and long-term government loans and loan guaranties on concessional terms to supplement commercial funding of export sales. Loans are made directly to foreign governments and guaranties protect developed country commercial banks against nonrepayment by an LDC borrower.

-- Export credit insurance offers insurance to exporters extending "suppliers' credits" to foreign customers and to banks acting as exporters of record.

-- Project planning services finance prefeasibility and feasibility studies of major capital development projects in the LDCs as a means of introducing the sponsoring country's technology and promoting the sale of that technology on large infrastructural development projects.

-- Trade missions provide developed country industry representatives with access to potential buyers and opportunities to explore market prospects in selected LDCs.

-- Information services provide exporters with market data on specific countries and regions.

Export promotion programs are conducted in the United States by Eximbank, the Trade and Development Program, and the Department of Commerce. Until recently, AID has had little to do with the promotion of U.S. exports per se, although some of its development assistance efforts such as the Commodity Import Program serve that purpose incidental to the provision of needed goods and equipment to a particular LDC.

In recent years, however, AID has become modestly involved in the provision of mixed credits or, more particularly, associated financing in the parlance of the OECD Development Assistance Committee. The term "mixed credits" refers generally to the growing donor country practice of mixing ODA with traditional export promotion efforts to further the export of goods and equipment. "Associated financing" as defined by the DAC is a more narrow form of mixed credits which associates some combination of ODA or other official finance with a grant element of at least 20 percent and official private export credits at or near market terms.

The AID program, the Trade Financing Facility (TFF), was created in 1981 for the purpose of matching mixed credits offered by foreign competitors. It is limited geographically to use in Egypt and has only been used twice. The major U.S. program in this area is the concessional medium-term fixed interest rate credit program of Eximbank.

The official U.S. Government position is that such concessional export financing principally for commercial purposes distorts international trade, shifts scarce ODA funds from the poorer LDCs to higher income or more advanced LDCs, and skews development priorities toward sophisticated, capital intensive projects. Accordingly, the President's Task Force on International Private Enterprise has recommended in its draft report that the U.S. Government establish a $1 billion mixed credits program to meet the competition of other donors and to convince all concerned of the drawbacks of this practice.

Discounting possible distortions caused by mixed credits, the promotion of developed country trade with the LDCs is an important element in the process of technology transfer and the development of linkages that may lead to foreign direct investment. However, this area does not appear to be an appropriate one for AID or the development assistance community more broadly.

LDC Exports. The export of LDC raw materials and equipment and other manufactured or processed goods can also develop linkages leading to developed country investment in the LDCs. Programs that assist LDC export promotion have been described earlier in this section. This is clearly an area of opportunity for AID programming as only modest attention has been directed to this subjectin recent times, and that primarily by PRE as indicated previously. In general, AID, because of its extensive network of field Missions, is particularly well suited institutionally to assist LDCs to develop the capability to export to the developed countries.

Investment Promotion

As indicated earlier, the investment process can build on, but need not necessarily await, the establishment of commercial linkages between developed country and LDC firms. Investment opportunities can be identified and developed. A project opportunity can be identified and developed into proposal form within an LDC and then matched to an appropriate developed country investor. Or a developed country investor with a project to promote can be found and matched to a suitable LDC location. In either case, projects cannot be proposed in the abstract but must be paired with potential investors, either developed country or LDC, as a prerequisite to the promotion process.

Based on experience to date, several steps are typically required to implement an effective investment promotion effort, that is, one that begins with project identification and leads to a decision by a developed country investor to study the feasibility of a direct investment, either on his or her own or in collaboration with an LDC partner. These include the following:

-- Establishment of an appropriate investment climate

-- Country promotion

-- Project identification

-- Project formulation (prefeasibility planning)

-- Partner brokering

Many opportunities exist for donors to assist the implementation of these various steps in the investment promotion process.

Establishment of the Appropriate Legal, Regulatory, and Policy Environment. The first step in the investment promotion process is for an LDC to create a legal, regulatory, and business climate attractive to foreign investors. Active promotion in the absence of a proper policy environment is a generally pointless endeavor. Many donors, including AID, have found considerable opportunity to assist in the process of policy reform and institutional development necessary to establish the desired investment climate. Such assistance has taken the form of helping to prepare investment laws and country investment guides and has helped in providing training and advisory assistance to local investment promotion agencies. Clearly, many opportunities exist for AID to assist in this area.

Country Promotion. The next step in the process is to make known to a wide spectrum of potential investors in the developed country the fact that a country's welcome mat is out, that an attractive investment environment has been established, and that the country has opportunities available. However, such an effort requires, at least to some degree, a direct and often sustained contact with the developed country investment community which most LDCs lack the resources to undertake. Donors have consequently found various opportunities to assist this stage of the investment promotion process.

For example, AID has recently cosponsored with the Tunisian Investment Promotion Agency a general promotional conference in Tunisia to which some 20 to 25 relatively major (i.e., Fortune 500) U.S. companies sent representatives. The Tunisians took full advantage of the opportunity to present a persuasive case for investing in Tunisia. Some donors, such as the DEG in West Germany, take the initiative to evaluate individual countries and promote directly to their own investors those countries they believe represent the best investment opportunities.

Identification of Project Opportunities. Once the LDC business climate is in place and the country's interest in foreign investment known, the most difficult part of the investment promotion process begins, that is, identification of project opportunities. Unless projects emerge naturally from an established commercial linkage, or from a developed country or LDC firm's own initiative, they must be created, either by seeking out investment opportunities in the LDCs directly or by identifying developed country investors with project interests to promote. Donors have pursued two distinct approaches to the process of project identification: (1) some assume responsibility for project identification directly or through private surrogates, and (2) others help the LDCs to develop the institutional capacity to undertake the process themselves.

The principal approach to project identification logically focuses on finding projects within the LDCs. Donors typically take the initiative and participate actively in this process. For example:

1. The IFC, the most experienced of the donors in this area, sends its investment officers on frequent field trips to identify project possibilities and nurture the project formulation process to fruition. It also maintains officers abroad in eight or nine locations. The CFTC follows a similar practice. Staff from its special Industrial Development Unit make frequent visits to member countries to seek out project possibilities. PRE follows this practice as well.

2. CDC, the German Business Cooperation or BC program (through private consultants) and PROPARCO (through offices of the Caisse Centrale) also take the initiative in identifying project possibilities, but from permanent posts in the LDCs.

3. Similarly, the USAID Mission in Egypt cosponsored with the Egypt-U.S. Business Council the establishment in 1983 of a U.S. Investment Promotion Office (USIPO) to identify project investment opportunities for U.S. investors in the priority sectors of the Egyptian economy. Also, through its PDAP program, AID has posted consultants in several Caribbean countries for the purpose of identifying project opportunities.

A related approach is to solicit project proposals from LDC sources and make them available, by "passive brokering," to interested parties. Both OPIC and UNIDO maintain project or "opportunity" data banks for this purpose. Experience suggests, however, that projects in the abstract do not lead very far. Even if the proposals have sponsors attached, the ideas do not develop without active promotion, which neither OPIC nor UNIDO apparently provides for their data bank projects.

The foregoing describes various approaches donors have used to participate directly in the project identification process in the LDCs, either through their own officers or surrogate consultants. This is indeed the preferred approach by the donors and the one that appears most successful to date.

Donors that simply assist the development of project identification capability within LDCs or groups of LDCs without directly involving themselves in the process appear to have had less success. UNIDO's Investment Promotion Program, for example, trains LDC personnel in investment promotion techniques to work both in their home country and in UNIDO investment promotion offices in the developed countries. A major problem experienced so far in terms of the success of the program within the LDCs is the inability of the participating LDCs to identify sound project opportunities.

A second general approach to the project identification process is to look to developed country investors for project ideas.

1. OPIC follows this approach by preselecting U.S. enterprises with an interest in investment opportunities and then introducing them to specific LDCs through its program of investment missions. CIDA has a similar program. OPIC missions have produced hundreds of project discussions and are greatly in demand by the LDCs. Although many of the projects discussed do apparently materialize over time, OPIC sources indicate that the investment mission approach to project identification is costly and time consuming.

2. The DEG conducts seminars in major cities in West Germany to elicit investor interest and proposals. Also, interested West German investors are encouraged to contact BC program offices in West Germany if looking for a location for an investment project. Project ideas are then conveyed to BC counterpart personnel in the LDCs to vet the idea and look for appropriate partners. The French CEPIA program pursues a similar approach.

3. The most labor intensive U.S.-based project identification effort has been the Entrepot project sponsored by TDP in Tunisia. A U.S. consultant firm has been responsible for identifying U.S. firms with an interest in exploring project possibilities in Tunisia, introducing these firms and their project proposals to potential Tunisian partners and helping them arrange financing.

Although several projects are under serious consideration, the effort appears to have been a costly one up to this stage.

It is not clear how cost-effective these approaches are in terms of economic activity actually generated. Investment missions, in particular, are organized at considerable expense.

A third_approach, a variation of the second which appears to be unique to the IFC, begins at the planning level. Certain opportunity sectors or opportunity industries are identified; that is, industries with unsatisfied markets or market-creation possibilities in the LDCs. The IFC then presents the general idea to appropriate developed country industry associations. Interested firms are identified and engaged in a project exploration process with the IFC in suitable countries.

As is evident, there is a potpourri of approaches to the project identification process. Experience to date suggests that the bulk of donor effort in this regard should be concentrated within the LDCs. The effort should also, at least in the near term, be undertaken by donor agencies themselves or through developed country firms, either by frequent travel to the LDCs or through the posting of specialized personnel in the LDCs. A strong case can be made that there is a need for a donor representative within an LDC to help reassure risk-averse investors that the investment climate is secure.

Approaches that rely primarily on LDC institutions to identify project possibilities, although necessary to the long-term development of the LDC, will,in the short run, likely find the promotion process retarded while waiting for LDC personnel to be trained and develop necessary skills. The UNIDO approach therefore appears to be somewhat a case of misplaced priorities. The immediate objective of the investment promotion process is not to develop official LDC investment promotion personnel; rather, it is to find project ideas with the potential to lead to foreign direct investment.

Project Formulation (Prefeasibility Planning). In some cases a prospective developed country investor will come to the LDC with a relatively well-developed project profile in hand looking for an appropriate partner and ready to adapt the project to the local LDCs face a buyers' market because of the lack of interest or reluctance of requirements. More frequently, however, projects have to be developed locally and "sold" to developed country investors. In general, developed country investors, particularly SMEs, to get involved in a project abroad. In order to attract foreign investors to "buy into" a project, they must be offered an attractive "product"; that is, a sound and viable project proposal. Moreover, such projects need local sponsors to ereally attractive to the typical potential developed country investor.

Project formulation is, however, a complex and challenging task, and few LDCs are capable of undertaking sophisticated prefeasibility analyses, as suggested by the USAID experience with the Inter-American Investment Development Center. The Center, located in New York, was to serve as a "clearinghouse" for matching Latin American projects with U.S. investors. It failed because participating countries were unable to produce attractive project proposals.

Not surprisingly, the approach of most donors is to provide direct assistance to the process of project formulation. For example, such assistance is provided directly by IFC and CFTC staff, BC program consultants, overseas staff of the Caisse Centrale and the CDC, and, to some extent, by the U.S. Investment Promotion Office in Egypt. PDAP project consultants also assist in project formulation and development.

Another approach is to develop LDC resources for the purpose of project formulation. The USAID Mission in Egypt, for example, has provided courses in project appraisal to bankers in Egypt. The IFC is supporting the development of a Caribbean Project Development Facility to review and develop project proposals to a quality level acceptable for funding. Although this latter project appears successful, most such efforts will take years to develop and become effective.

Experience to date suggests that under current circumstances the key to the investment promotion process is the development of attractive project proposals and that this can best be accomplished in the near term by the direct and substantial participation of donors themselves or their surrogates.

Partner Brokering. Partner brokering can be required at various stages in the project development process and can be required either in the developed countries, the LDCs, or both. Frequently, it is needed at the stage where one partner, either developed country or LDC, has a project idea for which he needs a counterpart partner. In any event it generally appears prior to a decision to move to the feasibility study stage.

If the objective is finding a developed country partner for an existing LDC project opportunity, several bilateral and multilateral programs are instructive. In each case the developed country partner search is undertaken by an established, continuing institutional structure in the developed country.

-- In the case of the IFC and the CDC, their own staff of investment officers seek out developed country partners.

-- In that of the DEG, it occurs through the Business Cooperation program's network of private German consultant firms.

-- For the French PROPARCO and CEPIA, their headquarters staffs work through French Chambers of Commerce, industry associations, and so on.

-- With AID's PDAP regional project in the Caribbean, a permanent U.S.-based consulting firm is used for U.S. partner brokering.

-- As for UNIDO, it follows a similar approach but with a critical variation; it uses LDC staff in its developed country investment promotion offices. This approach does not appear to be as successful a model as the others. The LDC personnel responsible for the program are generally inexperienced and because of language and cultural reasons find it difficult to penetrate the developed country industrial community.

AID has had limited experience with the developed country partner search process. In one such case, the "Egypt-U.S. Investment Workshop" attempted the approach of a "one-shot" conference. Egyptian businessmen were brought to the United States to be introduced to U.S. companies preselected to match up to projects proposed by the Egyptians. No joint ventures emerged from the event, generally owing to a lack of well-developed project possibilities; the inexperience of U.S. businessmen in the international market; and their lack of the necessary technical, managerial, and capital resources to undertake investment projects abroad. The workshop demonstrated, however, that the developed country partner search effort can be successfully carried out by a developed country investment promotion consultant operating from a developed country base. The obvious flaw in this approach is that it lacks permanence and continuity; that is, conferences would have to be planned and organized on a continuous basis to provide the sustained partner brokering services an LDC requires.

In another approach, OPIC and UNIDO both offer passive brokering assistance through computerized data bases of potential developed country partners. OPIC maintains in its Opportunity Bank a roster of some 4,000 potential U.S. investor-partners as support to the partner brokering process. Rapidly changing interests and circumstances of individual firms and the difficulty of keeping the roster current may substantially limit the effectiveness of this program. UNIDO's experience in this regard might merit further analysis.

Finally, the West Germans have had some success by bringing groups of LDC investors to trade fairs in West Germany to make contact with potential partners. This approach has so far only been tried with India and may not be applicable to countries with less of an industrial base. The Canadians are trying a similar approach but their experience so far is limited.

If the objective is identifying LDC partners for developed country investors, most donors agree that some degree of direct intervention is required at least in the short run. Almost all maintain staff in the LDCs whose duties include LDC partner search. Such brokering is frequently part and parcel of the project identification process within the LDC, but it is also often in direct response to requests from developed country investors.

Several lessons can be learned from partner brokering experience to date. To be effectively undertaken on a continuing basis, brokering of partners forforeign direct investment projects requires an institutional structure in both the developed countries and the LDCs. This structure should be linked and mutually reinforcing. For the near term, direct donor participation in the brokering process, particularly that in the developed countries, is necessary to ensure the expeditious execution of the partner brokering function.

4.4.2 Support to Investment

Once project possibilities are identified and formulated into viable project proposals, the next step is project preparation, of which the study of the financial and technical feasibility of the project proposed is the most important first step. Feasibility studies are generally undertaken in conjunction with the arrangements for project finance. However, many developed country firms never reach the point of feasibility study because of a lack of capital or a concern for the risks involved in LDC investment. Most donor governments have established programs to assist their nationals deal with these three matters: feasibility studies, finance, and risk. Some have also developed programs to support technology transfer as a form of feasibility effort.

Project Preparation

Feasibility Studies. All major bilateral donors have programs that support the undertaking by their own nationals of project feasibility studies in the LDCs. In the United States, OPIC, the Trade and Development Program (TDP), and AID all sponsor such programs. These programs are generally made available to firms with limited resources and international experience to encourage them to explore LDC project opportunities. Typically, these programs provide a kind of contingent reimbursable grant of up to 50 to 75 percent of the costs of the study, within specified limits. The grant is only repayable if the project goes forward. Experience to date suggests that support of feasibility studies can be an important, even critical, element in a developed country firm's willingness and, indeed, ability to pursue an identified project idea.

The TDP-sponsored Entrepot Project in Tunisia, for example, identified a number of smaller U.S. firms interested in opportunities abroad, introduced them to the Tunisian market, helped identify partners, and elicited good project prospects for several participants. That those participants continue to pursue the project possibilities identified appears due almost entirely to the OPIC feasibility study program.

Technology Transfer. Some donors have viewed the direct transfer of technology or its development or adoption on-site as a subject of assistance and another means of project development. The Governments of France, West Germany, and Canada each have a program and PRE has initiated one.

The French program is run by the Agence Nationale pour la Valorisation de la Recherche (ANVAR), a public enterprise created and controlled by the Ministry of Research and Technology but run on an independent financial basis. ANVAR's mission is to promote the development of new technologies and the modernization of industry, primarily in France. ANVAR has recently created a special program to encourage the development of new technologies for projects in the developing countries. The program is open both to French enterprises and research laboratories.

ANVAR grants 50 percent of the research costs of projects to develop new products or processes specifically aimed at the LDCs and/or developed in cooperation with an identified LDC partner. For projects aiming simply at the introduction into the LDCs, in cooperation with an identified LDC partner, of established new products or processes, ANVAR offers grant financing up to 75 percent of the project. In its first year of operation, the ANVAR/ LDC program has supported about 20 specific projects for the LDCs. Although many of these involve private sector enterprises, the ANVAR/LDC program carries no special brief for private versus public sector. Its current annual budget is about $500,000.

A low-interest loan program to assist West German firms to introduce new technologies in the LDCs by financing up to 50 percent of the West German firm's participation was set up in 1981 by the KFW but has so far not lived up to expectations and will likely be eliminated in the near future. Its failure may have been the result of over restrictive conditions: the project must be a joint venture with an LDC company; it must produce for the local market; it must solve a specific LDC problem; and it must be introduced to the LDC for the first time.

As previously indicated, PRE has recently initiated a technology transfer program similar to those just discussed, called the Commercialization of Technology. It will fund both the sale of technology and joint ventures involving technology transfer. The Canadian Technology Transfer Facility funds testing, adaptation, and demonstration of Canadian technology in the LDCs.

To date there is insufficient donor experience with the approach of promoting technology transfer (development or adaptation) through developed country enterprises to judge its prospects. One major deterrent to such programs, as currently structured, is that support presupposes the existence of a developed country/LDC joint venture relationship, which in itself is a major task for which the programs provide no help.

Another AID approach has been to provide central funding for Appropriate Technology International (ATI), a private organization whose purpose is to promote the development and dissemination of appropriate technology in the LDCs. ATI's approach is experimental, providing small grants, credit, and technical assistance to grassroots LDC organizations to test, adapt, and demonstrate technologies. One shortcoming has been ATI's inability to establish greater linkage to the U.S. private sector, a problem which the creation of a Business Department in 1981 is expected to overcome.

Financial Support

Among donor financial institutions, particularly the IFC, DEG, and CDC, the provision of direct loan and equity financing is ostensibly the principal purpose of the organization. The experience of these institutions suggests that the provision of capital, although important, may not always be the most important service offered. As already indicated, these institutions play an important catalytic role in project identification and formulation and in partner search. Beyond that they are able to mobilize other sources of finance, variously by syndicating their own loans, underwriting stock offerings, and arranging cofinancing of projects.

Of perhaps greater significance in the mobilization of developed country investor interest is the "umbrella" function served by the participation of the CDC, IFC, or DEG on a project, particularly a participation in equity. The prestige and influence of these donor institutions is so great that many developed country private investors' participation can only be secured with their involvement. In addition to providing the protection of a large and powerful partner, such assistance sometimes serves as an equity-stretcher to give the developed country investor the sense of practical control it needs over an LDC joint venture in cases where the developed country investor is not permitted to hold majority ownership. The developed country firm effectively obtains control by coupling its share with that of the passive involvement of, for example, the DEG. Conversely, in many cases an LDC government's agreement to foreign participation in a project can only be obtained with the financial involvement of an IFC, CDC, or DEG.

These principles appear to some extent to be transferable to the LDCs themselves, as the case of Tunisia suggests. In Tunisia the establishment of several prestigious private development finance corporations financed by outside (mainly Arab) sources willing to provide both equity and loan capital seems to be a stimulus to developed country investor involvement.

The relative success of the IFC, DEG, and CDC at mobilizing developed country investor participation in LDC projects suggests the possible desirability of creating a similar institution in the United States or, at a minimum, permitting existing U.S. institutions to take equity positions. Currently, the only direct loan programs in the United States are efforts within OPIC and AID/PRE, the latter being quite modest. Neither can take equity participations, which is a critical element in the success of the IFC and others.

Noneconomic Risk Insurance

Most major bilateral donors have noneconomic (i.e., political) risk insurance programs to protect against the risk of instability and expropriation without compensation. OPIC runs the U.S. program, which in 13 years has grown to a multibillion dollar program. OPIC's success attests to the need for its services as well as its ability to respond effectively to the requirements of the market.

4.4.3 Postinvestment Assistance

Although a case can be made that once a private, developed country/LDC investment project is underway, it should be left to its own devices to sink or swim in the private sector, donors do not necessarily espouse this view. As has already been indicated, several donors offer export promotion assistance to potential LDC exporters.

Donors also provide training and technical assistance to LDC private enterprises. Such assistance is presumably equally available to the developed country/LDC joint venture.

The West German aid program offers assistance to training programs organized by West German firms working in the LDCs. The object of this program, the In-Plant Training Program in Developing Countries, is to expand formal in-plant training in the LDCs and in particular to support the training activities of West German enterprises active in the LDCs. In principle, any in-plant training program in an LDC intended to meet medium-term or long-term requirements for skilled personnel in one or more enterprises may receive support. This will include programs involving West German firms primarily, but in selected cases also those of local LDC companies and LDC training centers. The support takes the form of subsidies of up to $125 per trainee per month.

Most major donors have organized senior executive service corps to provide practical managerial and technical advice to LDC private enterprises, principally SMEs. Assignments generally last from 1 to 3 months. The services of the senior executive are provided on a voluntary basis or for a modest honorarium; the LDC firm helps to defray the costs of the executive's stay in the LDC, usually by payment in-kind. The 10 active services have provided some 1,500 experts for 15,000 assignments in the LDCs since the first program, that of the IESC which was established in 1964. The IESC, which has accounted for some 9,000 of the 15,000 recorded assignments, has received strong support from AID -- more than 50 percent of its funding. Its undeniable success at the transfer of both technical and management technology argues strongly for its continued support. A similar program run by the Joint Agricultural Consultative Corporation focuses on the transfer of agribusiness technology.

The IFC, DEG, and CDC all appear to provide a further type of postinvestment assistance. By serving on the boards of directors of the projects in which they take equity positions, and in CDC's case actually managing some projects, these institutions provide a dimension of organizational sophistication that can sometimes make a crucial difference in the implementation of the project.

4.4.4 Summary and Conclusions

Experience to date suggests that there is both great need and great scope for mobilizing increased developed country private investment in LDCs. It also suggests that, at least in the near term, the effort will require active promotional activity at the preinvestment stage and support of both the investment process and the postinvestment project implementation phase. Programs of investment promotion and support must be mounted in both the developed countries and the LDCs. Moreover, there will be a need for substantial and direct developed country involvement and participation in the establishment and operation of these programs. Although some of the required programs and institutions are already in place in the United States, the United States, in general, lags far behind European donors in this area. Probably the most complete and most effective model established to date for the mobilization of developed country investment in the LDCs is that of the West German aid program.

The Germans provide a comprehensive package of programs and services to link West German private investment to LDC project development, including the following:

-- Technical assistance to LDC investment promotion agencies

-- Promotion of trade links to LDCs

-- Promotion of specific LDCs as investment opportunities to German investors

-- Investment missions

-- Project identification, formulation and partner search through private consultant/advisors in selected LDCs backstopped by counterpart advisors in West Germany (Business Cooperation program)

-- Financing of feasibility studies

-- Support for technology transfer projects

-- Provision of loan and equity capital through the DEG

-- Political risk insurance

-- Supervision by the DEG of project development by way of positions on boards of directors on those projects it supports

-- Assistance to training and export promotion efforts for West German-sponsored projects

-- Technical and management assistance through a senior executive service corps

That this kind of comprehensive program of promotion and follow-on support can produce results is evidenced by West German success in Tunisia; following a decade of promotional activity there are now over 100 West German investment projects there which have generated more than 10,000 jobs.

The West German approach, although expensive, works.Whether it repays its cost in the degree of investment and economic activity it generates is still unclear. Leaving aside the question of cost-benefit, the major lessons of this approach appear to be the following: a comprehensive set of programs is required; those programs must be applied simultaneously and intensively on a county-by-country basis; the effort must be sustained over an extended period of time (e.g., a single promotional conference, although perhaps necessary, has limited potential); the heart of the investment process is the identi-fication of project opportunities within LDCs; the successful implementation of investment promotion programs requires a devel-oped country-staffed office within an LDC, backstopped by a devel-oped country-staffed counterpart office within the donor country; and much of the work, such as organizing promotional efforts, project identification and formulation, partner search, and so on, is best done by donors themselves or hired out to developed country private firms and specialists.

Although it seems clear that the United States currently lacks many of the tools necessary to mobilize an expanded level of U.S. private investment abroad, it is not equally clear how these tools should be developed. AID appears to be the most likely candidate to develop these tools because it is the only U.S. institution with sufficient experience in the LDCs, an existing administrative apparatus to operate and oversee programs abroad, and a capability of planning and managing an effort that must operate simultaneously at home and in the LDCs.

This is not to suggest, however, that AID need assume responsibility for the implementation of each of the panoply of programs required. Rather, AID might take the initiative in the design and development phases of new institution-building efforts, encouraging the formation of new public and private organizations to perform the necessary functions. PRE, for example, might design a program along the lines of the German Business Cooperation program and promote the concept with USAID Missions in selected high-potential countries. PRE and the Missions might thereafter cofinance country- or regional-specific programs.

5. IMPLICATIONS FOR FUTURE AID PROGRAMMING IN THE PRIVATE SECTOR

The subject matter of this report is broad, encompassing a wide range of experience and a large number of issues. This section highlights some of the key findings of the report and attempts to draw together major implications for the immediate future -- a period during which AID's experience with 4 years of private sector development can serve as the basis for sharpening the focus and significantly expanding the scope of the initiative.

Major findings are summarized in six sections:

5.1 The Development Rationale of the Private Sector Initiative

5.2 Implementing the Policy Dialogue

5.3 Providing Assistance to Developing Country Private Sectors

5.4 Delivering Assistance Through Private Sector Organizations

5.5 Involving the U.S. Private Sector in Development

5.6 Implications for AID Programming and Project Implementation

Some suggestions for further research and analysis are provided at the conclusion of this section.

5.1 The Development Rationale of the Private Sector Initiative

The importance of placing primary reliance on market mechanisms and the growth of the private sector to achieve development objectives is confirmed by the appraisals of major donor agencies and, as evidenced by the literature reviewed for this study, by a growing body of development professionals.

Private sector-based development approaches require the following:

-- That profitable opportunities for private enterprises exist. Government polices and regulatory practices are major determinants of both the business climate in developing countries and the scope of action which is permitted to the private sector. The adequacy of available infrastructure and the efficiency of public administration are also key determinants of private sector growth potential.

-- That profitable opportunities coincide with socially beneficial activity. Government policy exerts a major influence -- positive or negative -- on the efficiency of markets. Governments also have a role in diminishing or accentuating the negative effects of market failures.

-- That private enterprises have the capacity to respond to profitable opportunities. A major role of governments and donors seeking to achieve private sector - based development is to assist enterprises in developing the capacity to perform their functions efficiently.

Government policies and regulatory practices that distort markets emerge as one of the most important constraints to the achievement of sustained and broadly based growth. An inappropriate policy environment represses or distorts the domestic economy, discourages trade and foreign investment, and prejudices the effectiveness of development assistance resources. Helping developing countries to achieve a more favorable policy environment -- and sustain the costs of transition -- therefore becomes the most important objective of private sector development assistance.

It follows, therefore, that direct assistance to governments -- in analyzing policy, developing the institutional capability to effectively implement policy, improving the administration of public services, and achieving a greater market orientation -- can and must be an integral part of private sector development approaches. Assistance provided to enhance the efficiency and market orientation of parastatals, or to achieve their privatization, can also be required for private sector development support.

Trade -- commerce -- is the very stuff of which markets are made. It is fundamental to the natural processes of growth, technological change, and investment. Development assistance must devote more attention to the facilitation of trade, domestic and international. A need exists to support the development of marketing systems and institutions, and to build upon such channels for increasing the flow of both technology and private investment.

5.2 Implementing Policy Dialogue

Experience with policy dialogue has shown that it can be effective in securing change when the dialogue is conducted over a specific and well-defined set of issues, when AID has been able to support dialogue with high-quality analysis, and when AID has shown staying power in conducting the dialogue. Supporting good policy analysis can be effective at relatively low cost even when the dialogue is not linked to large amounts of funding. The leverage provided by large-scale program or sector lending can of course be instrumental in achieving policy reform, but leverage does not substitute for, and can be counterproductive in the absence of, high-quality analysis.

Such analysis needs to be pragmatic and to go beyond the rhetoric in order to provide a reliable understanding of how policies are actually implemented. It also needs to go beyond the macroeconomic sphere to encompass policies, sometimes critical, that are implemented at the microlevel. Finally, it must provide a realistic assessment of the limitations of policy and an understanding of nonpolicy constraints which may be relevant.

There are many avenues and levels available for conducting the policy dialogue, more or less appropriate depending on the circumstances and opportunities presented in specific countries. Domestic private sector representatives should be encouraged to contribute to the policy dialogue, and major efforts should be made to build domestic capacity for policy analysis. International private sector representatives, whether business assocciations, prospective investors, or potential trading partners, can be effectively used to provide advice on specific policy questions. Avenues for collaboration with other donors in dialogue with developing country governments are well known. There is a significant potential for AID to contribute more actively to such collaborative efforts, however, for example in assistance to governments in analyzing and designing policy reforms preparatory to participating in a World Bank Structural Adjustment Loan. The Bank has found that constraints in government capacity to prepare adequate policy programs have retarded implementation of its SAL program.

It is advisable that policy dialogue be undertaken on a regional basis in some instances. Regional treaty organizations such as the Central American Common Market (CACM), Caribbean Common Market (CARICOM), the Andean Pact, Association of South East Asian Nations (ASEAN), and Economic Organization of West African States (ECOWAS) usually bring together countries with similar characteristics and also restrict individual member governments in their ability to individually alter policies, especially in the areas of trade and foreign exchange.

A consistent approach toward such groups, which takes account of their interdependencies, provides an alternative, possibly less confrontational, avenue for policy dialogue and offers the potential for mutual reinforcement among countries in adopting and implementing changes.

Finally, there appears to be a need for a more consistent and coherent U.S. Government approach to the policy dialogue with developing countries. The linkage of U.S. trade policies, for example, to policy reform in developing countries, could vastly increase the effectiveness of the policy dialogue.

5.3 Providing Assistance to Developing Country Private Sectors

For AID and other donors, a major means of providing assistance to the private sector is through development and financing of financial intermediaries. As in other sectors, a major finding of this review is that the achievement of an appropriate policy environment -- not the transfer of external resources -- is the priority need.

This finding comprises two parts. First, it is a strong conclusion that policies external to the financial sector are crucial determinants -- through their impact on the demand side of financial markets -- of efficiency in the allocation of investment resources. Such policies can have a distorting influence on the size structure of firms, their factor intensity, and market orientation, and must be addressed if the development impacts of external resource transfers are to be achieved.

Second, within the financial sectors of many developing countries there is also an urgent need for policy, legal, and regulatory reforms to liberalize pricing in credit markets, facillitate the entry of new firms, and stimulate competition. Such measures are particularly urgent to permit the development and growth of financial institutions that can effectively serve the needs of the small borrower, of startup ventures, and of long-term capital investment projects.

Subsidies and regulation are not a sustainable long-run solution to meeting these needs in their entirety. Available concessional resources will need to be more carefully targeted and other commercial solutions found to serve a larger portion of demand. With the introduction of competitive commercial service to high-cost, high-risk credit markets, a natural focus of development assistance is likely to become the provision of technical assistance, technology, and training -- to both lenders and borrowers -- to reduce financial transaction costs and interest rates, thus increasing access to these markets through self-sustaining growth.

The predominant focus of development assistance to LDC private sectors has been, and should continue to be, small- and medium-scale enterprises, in both urban and rural areas. Generally, assistance programs combine credit with technical assistance, technology transfer, or training efforts. This is in recognition of the fact that access to capital, while important, is often not the binding constraint on

SME development. Access to markets, information, management, and technology are at least of equal importance and are therefore a major focus of SME assistance efforts.

Although many studies have indicated the very high economic returns to well-implemented small- and medium-scale enterprise development projects, provision of the required technical assistance services in a manner that is financially self-sustaining has proven difficult.

One solution which has been widely successful is the use of private voluntary organizations to perform these functions. Expanded use of PVOs is to be encouraged, provided that they can also be assisted in the development of fund-raising mechanisms that can provide them with some assurance of sustained involvement and organizational viability.

Large firms can also be a major source of technical assistance, technology, and training for small and medium entrepreneurs through subcontracting and contract-buying arrangements. Policy can be an important element in either encouraging or discouraging the growth of subcontracting between large and small firms, however. Taxes on interfirm sales and semifinished products can, for example, encourage vertical integration and discourage subcontracting. Donors can be of assistance in encouraging the growth of subcontracting through policy, legal, and regulatory analysis and advice, and through direct support to subcontracting relationships by providing parts of the necessary technical assistance, technology, and training package.

Available evidence seems to point to the greater effectiveness of technology transfer as opposed to technology development efforts. The latter have encountered difficulty with achieving market acceptance and commercial manufacture, while transfer, with or without a degree of adaptation, is facilitated by the existence of established commercial channels and support systems.

Similarly, there is some evidence of the greater effectiveness of management and technical skills training programs relative to vocational training programs. Vocational training has often been unresponsive to changing job market demands, and there is some opinion that such skills are most easily developed on the job.

5.4 Delivering Assistance Through Private Sector Organizations

Although AID is in the forefront of donor organizations in actively seeking opportunities to make use of developing country private institutions as delivery mechanisms for assistance, the conclusion of this review is that such opportunities remain largely untapped and represent an enormous potential for increasing the scope and impact of the private sector initiative.

Such potential exists in virtually all major areas of AID program activity: agricultural credit, research, and extension; health and family planning services; technical assistance and training for small-scale enterprises; and the development and dissemination of technology. PRE is actively engaged in developing such approaches, and Missions should be actively encouraged to do the same.

Some assistance to governments may be appropriate in this regard, for example by assisting them in improving their capacity to select and monitor contractors, or in developing small-scale decentralized alternatives to capital-intensive infrastructure such as irrigation dams.

5.5 Involving the U.S. Private Sector in Development

Numerous opportunities likewise exist for encouraging the greater involvement of U.S. private sector technical and financial resources in AID development assistance efforts. Potentially fruitful areas for such involvement that have already been touched on include the development of policy advice, technical assistance, management and technical training, technological development, and commercialization.

It is however, as potential trading partners and as potential investors that U.S. private sector firms can most directly and most significantly assist in stimulating the growth of LDC private enterprises. The need for donor assistance in encouraging the growth of investment capital flows from developed countries such as the United States into developing countries is particularly acute. Ironically, while developing countries are becoming increasingly aware of the need to encourage foreign investment -- a consequence of their external debt and domestic fiscal situations -- weakened economic prospects and the increased financial instability of LDCs has made direct investment less attractive to developed country businesses. This is especially true for small- and medium-scale developed country businesses which represent a large potential pool of investment resources for the LDCs, but which lack the experience, information systems, and institutional strength to venture forth in troubled times.

To assist developing countries to attract the private capital investment resources they require, donors can be most productive by helping LDCs to achieve a hospitable business and investment climate. As ever, policy assistance is the key.

There is an additional need, however, to assist developing countries in the development of active investment promotion programs -- firmly grounded in their domestic private enterprise development programs. The review of donor experience with investment promotion conducted for this study clearly indicates that the main focus of investment promotion must be the identification and formulation of sound project opportunities within the LDCs. Such project opportunities should be matched to local entrepreneurs before the search begins for a developed country partner.

Second, investment promotion efforts must be country-specific, though based on an institutional structure in both the developing and the developed country, that is interlinked and mutually reinforcing.

Investor missions organized by developed countries to promote their project ideas appear to be considerably less productive and less cost-effective than focusing project identification efforts within the LDC

By the same token, however, an institutional capability to communicate project opportunities to potential developed country investors, and to actively pursue the search for investment partners, is also required.

Over the near term, provision of the requisite institutional capabilities in both the LDCs and developed countries requires donor support. Developing country capabilities in project identification and preparation, and in effective developed country partner search, are in general currently inadequate to achieve results quickly enough to meet LDC needs. In the interim, donor supported programs can serve to develop capacity within the LDCs for investment promotion over the longer term.

Donor institutions such as the IFC, DEG, and CDC play an important role in stimulating developed country private investment that goes well beyond the provision of financial support. They are often the catalyst that identifies a project opportunity, locates the developed country and LDC partners, and arranges financial packages that mobilize additional resources. Their participation, particularly in equity, is frequently the factor that secures the investment of a risk-averse developed country investor or the collaboration of LDC governments with foreign private firms.

Because of a strong in-country presence and Washington-based resources, AID is well positioned to organize and oversee a major U.S. investment promotion effort for LDCs. Although AID itself is not in a position to participate in equity financing of foreign enterprises, it could be the catalyst for the organization of private or of quasi-official U.S. institutions to assume this role. PRE could provide the required leadership and oversight for the organization and development through USAID Missions of a fully integrated program. One effective model which may be considered is the German Business Cooperation program. This program hires individual consulting firms to implement country programs providing a full range of investment and trade promotion services. Offices in the LDCs are backstopped by counterpart offices in West Germany that undertake, upon request, West German partner search and provide necessary supporting services.

5.6 Implications for AID Programming and Project Implementation

Neither the funding nor the number of AID private sector projects appears to have increased substantially since 1982. Africa and the Near East lag significantly behind other regions in the volume of private sector programming. Globally, private sector programming needs to be substantially increased if it is to achieve its stated development objectives.

Ample opportunities exist for AID to increase the private sector content of its portfolio by building on areas of existing institutional strength and expertise in a manner that is compatible with current staffing, administrative procedures, procurement, and other regulations. Areas of particular institutional strength include agriculture and agricultural support services; agribusiness and rural enterprise generally; devel-opment and support of intermediate financial institutions; and specialized support to small- and medium-scale urban enterprises. These traditional areas of concentration offer major possibil-ities for building up a private sector focus and instituting private sector implementation mechanisms.

Areas that AID needs to develop further to extend the Private Sector Initiative include increased support for policy reform and the organization of a comprehensive and functional investment promotion program that is LDC-based but well linked to private resources in the United States.

Program areas that AID or other donors have pursued in the past but which do not appear to be fruitful for AID because of manpower limitations, excessive management intensity, or the developmental mandate of AID as an institution include (1) direct lending to individual LDC enterprises; (2) direct equity investment in LDC enterprises; and (3) support to U.S. investment or trade promotion, unless linked to specific LDC-based investment and trade promotion programs. However, these functions may be appropriate for other U.S. Government agencies or U.S. private sector organizations. And, to the extent that their activities coincide with the development needs of LDCs, AID may find productive opportunities for collaboration.

While the current AID program concentrates in a number of areas suitable for private sector-based implementation, many AID personnel lack firsthand knowledge of private business practice and the understanding of the private sector needed to enable them to identify constraints faced by enterprises or to recognize opportunities for developing private sector projects. AID staff is composed primarily of development professionals with strong social or applied science skills, but relatively more limited business and financial skills.

It is not necessary, however, that AID staff become businessmen or financiers to implement the Private Sector Initiative. It is only required that they be able to correctly identify private sector constraints, design projects that effectively overcome such constraints, and recognize opportunities to make use of private sector resources to support development programs. It is probably easier to teach these skills to development professionals than it is to teach development to U.S. trained businessmen and financiers. A major and necessary impetus to the Private Sector Initiative could be realized through a training program for AID career professionals. The IFC's in-house training pro-gram may serve as a partial model for AID training in this area, which could be organized with the collaboration of U.S. Business schools and trade and industry associations.

More specialized skills also need to be further developed to support the implementation of the Private Sector Initiative. Development of greater depth in skill areas such as investment promotion, financial market development, and international marketing will probably require a continuing recruitment program, supplemented by in-career training. PRE should continue its efforts to develop as a center of excellence in these specialties to enable it to provide ongoing technical support to USAID Missions.

Increased emphasis on project and program evaluation, and on improving project information systems, is essential to the internalization process needed for private sector development to become an Agencywide initiative. It is a genuinely new approach, with many potential pitfalls and many lessons to be learned.

At the same time, it is an approach that depends on innovation. AID personnel should be encouraged to assume the risks involved in innovation, accepting failures that occur for the lessons they provide, but especially for the exceptional payoffs that only risk taking can produce.

To assist in the process of identifying opportunities for innovation, it is suggested that AID Missions formally undertake periodic Private Sector Constraint Analyses. These should provide a comprehensive assessment, by major sectors of economic activity and for major input and factor markets, of both policy and nonpolicy constraints to accelerated growth of private enterprises. These analyses would provide an effective tool for guiding overall Mission programming. Complementary subsectoral analyses conducted in the course of project design would provide additional understanding of microlevel constraints and assist in identifying opportunities for making use of market mechanisms and private organizations to overcome them. As is emphasized by AID and other donor experience to date, it is essential to encourage the full participation of private sector groups in the processes of program planning and project formulation.

5.7 Areas for Further Research

5.7.1 Policy Dialogue

AID documentation and evaluation of its experience in conducting policy dialogue with developing country governments is insufficient to provide adequate guidance to Missions. While individual country situations vary, there are generic classes of policy problems which arise and also a number of alternatives which can be followed in dealing with each. A study of the policy dialogue could help to develop an understanding of the policy dialogue as process, and provide guidance on useful approaches at each step. The study should highlight experience with the use of leverage and conditionality and provide a comparative review of the use of program and sectoral, versus project, assistance in supporting policy reform. An analysis of the World Bank's structural adjustment lending program would be useful in this context.

5.7.2 Investment Promotion

The review of AID and other donor experience conducted for this study indicates the need, and the opportunity, for AID to develop LDC-based and developed country-supported investment promotion as a major area of program activity. A detailed design study of the institutional alternatives for implementing such a program would be required prior to its initiation.

5.7.3 Financial Market Innovation in LDCs

A real priority that emerges from this review is that of developing policy guidelines and institutional alternatives for more effectively meeting the financial needs of specialized groups in LDCs on a commercial and self-sustaining basis. These include small- and medium-scale enterprises, in particular, and their needs for both credit and equity finance. As reported in the text, some experience with commercial approaches in this area is beginning to accumulate. It needs to be brought together and systematically analyzed.

5.7.4 Case Study of the Linkages Among Trade, Technology Transfer, and Foreign Investment

Commercial relationships appear to be the most prevalent vehicle for the spontaneous transfer of technology and the generation of joint investment ventures between developed and developing country partners. Case studies of this process could provide useful guidance on how AID might devote its resources to accelerating what appears to be a natural process, and on means which might be used to incorporate target groups in developing countries into trade-based systems for technology and investment capital transfer.

5.7.5 Experience With Parastatal Privatization

The process of achieving parastatal financial viability, or a transition to private sector management, and/or private sector ownership, is fraught with difficulty. Even under the best of circumstances in which governments actively seek assistance in managing such a transition, intractable problems often appear. Experiences with alternative approaches to dealing with such problems need to be brought together and analyzed to provide guidance to USAID Missions in providing assistance in this area.

5.7.6 The Utilization of Large Firms in Development Projects

Large firms can provide stable markets, technology, training, and credit to small- and medium-scale enterprises that are the target of AID assistance. A study of policy, legal and regulatory measures that encourage or impede such relationships, as well as of ways in which AID and LDC governments can directly stimulate their coming into being, could help to uncover new methods of leveraging development assistance resources in support of private sector-based development.

APPENDIX A

ANALYSIS OF OTHER DONOR APPROACHES TO PRIVATE SECTOR PROGRAMMING

To provide comparative data on approaches to private sector programming, other donor programs were reviewed. These included such major multilateral donors as the World Bank, the International Financial Corporation (IFC), and the United Nations, as well as the more modestly endowed Commonwealth Fund for Technical Cooperation (CFTC); the large bilateral programs of France, West Germany, the United Kingdom, and Canada; and other U.S. Government-supported programs conducted by OPIC, Eximbank, and TDP.

1. MULTILATERAL ORGANIZATIONS

1.1 World Bank

The World Bank, established in l945, is owned by the governments of l46 countries. It lends money only for productive purposes and to stimulate economic growth in the developing countries where it lends. Principal sectoral emphases include agricultural and rural development, energy, and transportation. Each loan is made to a government or must be guaranteed by the government concerned. The International Development Association (IDA), a World Bank affiliate, was established in l960 to provide assistance for the same purposes as the Bank but to poorer developing countries on concessional terms. In l984 the World Bank made l29 loans totaling $ll.9 billion, and IDA proffered l06 credits worth $3.5 billion.

The World Bank does not have a development philosophy as such; its charter is officially neutral regarding the relative merits of private versus public sector development. A country's development ideology is accepted as is, and loan decisions are made on purely economic considerations. Nonetheless, the World Bank recognizes the importance of the private sector to economic growth and has traditionally supported and encouraged private sector development in a variety of ways.

As early as l956 the World Bank took special note of the importance of private enterprise by establishing the International Finance Corporation. Its function is to assist the economic development of the LDCs by promoting growth in the private sector of their economies and helping to mobilize domestic and foreign capital for this purpose. The World Bank has also played a leading role in promoting the establishment of development finance companies (DFCs) in the developing countries, the primary activity of which is to provide medium-to long-term finance to manufacturing units in the private sector. Since its first DFC loan in l950, the World Bank has provided more than $l3 billion in support of l30 such intermediate credit organizations in 80 countries, making these institutions an important target of World Bank assistance. Through DFCs, over one-half of all World Bank lending in industry has gone to the private sector, much of it to small- and medium-size enterprises.

The World Bank also assists private sector development by encouraging policy reforms in LDC economies that improve the climate for business and private investment. The most conspicuous example of this is the Bank's program of Structural Adjustment Loans (SALs). Begun in l980, the objective of these loans is to support policy changes and institutional reforms designed to achieve a more efficient use of resources; that is, to increase earnings of or save foreign exchange and thereby strengthen a country's balance of payments. Among other policy changes encouraged, reform of pricing policies, tariffs, fiscal incentives, budget subsidies, and interest rates may all improve the environment for private sector development. Similar reforms are also supported by the Bank through project and sector loans.

Recently, an internal task force at the World Bank has reviewed ways in which the World Bank can promote private enterprise in the industrialization of the LDCs. The review concluded that the World Bank could best pursue this objective by assisting policy reform, by developing and disseminating investment information, and by increased collaboration with the private sector in projects and activities related to Third World development. None of these recommendations has thus far been implemented, and none would apparently involve any major reordering of budgetary priorities or commitments.

Finally, the World Bank has recently completed a study on a Multilateral Investment Guarantee Agency designed to encourage the flow of resources to productive enterprises in member countries by insuring against noneconomic risk. The Executive Directors will likely make a decision on establishing the proposed agency sometime in l985. A similar proposal was made previously but rejected because many member countries see such a program as potentially encroaching on their sovereignty.

1.2 International Finance Corporation (IFC)

The IFC's mandate is to promote and support private enterprise in its developing member countries. It does so by bringing together entrepreneurs with both foreign and domestic capital for productive private or mixed public/private development endeavors. The IFC is authorized to make equity investments and to provide loans without government guaranties.

In addition to providing its own funds, the IFC raises additional financing, either directly through the syndication of its own loans or indirectly by helping to attract parallel financing from international capital markets.

In Fiscal Year (FY) l984, the IFC approved 62 projects involving a total dollar volume of $696 million in IFC funds, of which $64 million was in equity investment. Almost half of these projects involved mixed public/private enterprises in the LDCs, including 14 DFCs and other financial institutions. Total costs for the 62 projects amounted to approximately $2.5 billion, which demonstrates the Corporation's success in leveraging resources beyond its own.

The IFC frequently takes the initiative in the investment promotion process. Internal statistics indicate that IFC staff are involved in one way or another in identifying up to 60 percent of all IFC-financed projects. Its staff seek out project opportunities abroad, package financial resources from a variety of sources, identify local and foreign partners and sponsors, and monitor the progress of a project until its equity shares are sold.

The IFC has in the past concentrated on projects in the manufacturing sector but has now broadened its activities into agribusiness, mining, and energy. It also has a long tradition of supporting the development of capital markets and private DFCs by helping to establish leasing companies and to set up secondary mortgage financing programs, venture capital funds, and so on.

In addition to financial support, the IFC also provides technical assistance to project sponsors, which distinguishes it from commercial lenders. The bulk of this assistance is project related, consisting of legal, financial, and engineering advice. Of perhaps even greater significance is the "umbrella" function served by IFC participation on a project. The IFC's presence is often the critical factor in securing investor confidence in a proposed venture or in obtaining a government's participation in or agreement to a joint venture project with a foreign investor.

The IFC also provides policy assistance to member governments in support of efforts to develop the necessary investment climate to encourage productive domestic and foreign investment. Its leverage in such efforts is considerably less than that of the World Bank, however, because of the more modest resources at its disposal and because, as a private sector advocate, its views may tend to be discounted.

Some new activities of the IFC are assisting in the physical and financial restructuring of existing firms facing temporary financial difficulties but which are otherwise sound (corporate restructuring); helping to create a bonding facility for construction firms operating outside their own country; helping to establish a secondary mortgage market institution; providing financing for a regionally oriented venture capital company; and, for the first time, participating as a co-lead manager in a major equity underwriting for a diversified, closed-end investment company. The IFC also has recently become involved with a regional organization in the Caribbean area for the identification, preparation, and promotion of private sector projects.

1.3 United Nations

Although for obvious reasons the U.N. must assume a neutral policy posture regarding public versus private enterprise development, recent policy papers of the UNDP Administrator and decisions of the UNDP Governing Council reflect a growing concern with the need to tap the resources of the private sector for the benefit of the developing countries.

In his most recent report to the Governing Council, the UNDP Administrator stated that

> Ways are needed to enable the private sector, where governments wish, to participate in programme planning and in project formulation.... Also, direct technical support could be increased to specific groups including, in particular, artisans, entrepreneurs, and small-scale firms.... In many cases, industry associations and corporations would be the proper channels.

In a similar vein, decision 84/4 of the UNDP Governing Council, "Measures to be Taken to Meet the Changing Technical Cooperation Requirements of Developing Countries," contains policy statements considered by UNDP technical staff to represent a significant opening to the private sector approach. For example, paragraph 17 in particular is interpreted as a UNDP "New Direction," in stating that the Council

> 17. Welcomes further the Administrator's initiatives to strengthen and broaden the Programme's efforts to assist governments strictly in accordance with their priorities and expressly at their wish and with their consent, through collaboration with the private sector....

As for specific programs aimed at private sector development, there appear to be three U.N. programs currently active; one at the UNDP, another at UNIDO and a third, which was not visited, the International Trade Center in Geneva.

At UNDP, the program of interest is the Capital Development Fund (CDF). A $40 million a year program of small grants and loans in the lowest income countries, CDF has set up revolving loan funds from $1 to $2 million, making very small-scale loans to farmers and small industries and to finance small-scale community projects. Disbursement of these funds has been through co-ops, banks, PVOs, farmer associations, and so on. On-lending has until now been facilitated by the grant nature of the funds, but because CDF has recently begun to provide loans, appropriate on-lending terms to permit private financial institutions to serve small-scale borrowers profitably need to be formulated. The problem of risk taking in the financing of SMEs is also considered an issue needing resolution. CDF has engaged in joint financing with IBRD, is currently negotiating with IFC for future joint ventures, and is considering developing an equity finance window for SMEs. The CDF expressed an interest in working with AID on private sector projects.

UNDP is also considering the feasibility of a proposal to establish a Human Resources Facility that would finance the travel and local costs of experts from developed country industries to serve on a voluntary basis as short-term advisors to LDC private enterprise.

The other U.N. program involving the private sector is run by UNIDO and is called the Investment Cooperation Program (ICP). Established in 1975, the purpose of the program is to promote industrial investment projects in the LDCs. It does this by acting as a "marriage bureau" bringing together developed country investors and LDC entrepreneurs and, thus, generally promoting investment flows from north to south. Although it has no stated preference for either private or public sector projects in the LDCs, it is clear in its focus on promoting private foreign investment in the LDCs.

At its main office in Vienna, the IPC maintains an Investment Promotion Information System comprising four data banks. The Project File lists some 750 current project opportunities proposed by LDC sponsors. The Investor File contains offers of participation from public and private enterprises around the world. The Bank File contains offers of participation from national, regional, and international development finance institutions. The Institution File is a directory of LDC institutions likely to be engaged in the creation of new industrial projects.

ICP has also established UNIDO Investment Promotion Service offices in major cities of the industrialized countries. The offices are meant to perform investment brokerage functions between the host country and any country represented within the office. They are staffed by host country nationals and LDC nationals whose task is to promote the desired investment linkages. These service offices, which provide LDCs with an alternative to setting up a costly individual investment promotion office, also operate as a training ground for LDC nationals, most of whom have little previous experience in investment promotion work. The principal problem for IPC to date is the lack of adequate backstopping from the home countries, in particular the lack of well-prepared project profiles.

The International Trade Center in Geneva promotes LDC exports to the developed countries.

1.4 Commonwealth Fund for Technical Cooperation (CFTC)

The Commonwealth Fund comprises the 50 member states of the British Commonwealth. It was established in l97l to provide, at member government request, technical (no capital) assistance to Commonwealth developing countries. Its current budget is approximately $30 million. CFTC assistance falls into six main categories:

1. Experts, advisers, and consultancy services
2. The training abroad of personnel
3. Specialist consultancy advice on legal, economic, fiscal, and statistical matters
4. Assistance in setting up new industries
5. Assistance for the promotion of exports
6. Assistance in increasing food production and developing rural areas

The CFTC has no particular interest in private versus public sector development. However, two programs are of special relevance to private sector development: the Industrial Development Unit (IDU) and the Export Market Development (EMD) program.

The IDU was established in l980 and expended some $7 million during its first 3 years. It consists of a small unit of about one dozen industrial experts whose purpose is to initiate new industries, reactivate old ones, and help secure necessary financial and technical resources, paying particular attention to small- and medium-size projects and to the needs of the least developed countries. Among the functions of the IDU are the following:

-- Identification of specific industrial project opportunities, --often in consequence of an industrial potential survey

-- Preparation of project profiles

-- Conduct of project feasibility studies

-- Performance of appraisals of commercial viability

-- Conduct of market surveys

-- Selection and transfer of technology

-- Assistance to project agencies in finding sources of technology, capital goods, potential joint venture partners, and finance

-- Provision of on-the-job training

Up to the present time 355 projects have been assisted by the IDU, of which 80 percent are in the private sector. Of these, some 60 industrial projects are in the production stage, totaling some $5 million in investment and projecting annual production of $4 million and the generation of 2,000 jobs.

The EMD program conducts a range of projects aimed at developing LDC export sectors and increasing export earnings. Most EMD projects involve the provision of technical expertise in one of the following categories: establishing or improving a government export promotion agency; product development and adaptation; market studies, including advice on how to market specific products in certain countries; practical marketing exercises such as buyer-seller meets; trade missions and contact promotion programs; and training in market analysis and export marketing policy. The buyer-seller meet presents a range of carefully selected and adapted products from the supplier to potential buyers in the market, with the object of achieving immediate orders and developing long-term business. Follow-up action is taken to facilitate and maintain contacts and monitor orders. Contact Promotion Programmes, which normally deal with a more limited product range, are smaller, highly concentrated attempts to put sellers in direct touch with buyers, again after careful research in both importing and exporting countries.

The CFTC also provides, through its general technical assistance division, advice on investment policy and assists investment promotion agencies to improve their operating procedures. Finally, CFTC has in recent years begun to organize within member developing countries investment workshops which bring together real project possibilities with interested international companies. These workshops are sometimes organized in collaboration with UNIDO and other aid agencies.

2. OTHER BILATERAL DONORS

2.1 France

The French development assistance program is concentrated in Africa, more particularly in the former colonies of Francophone Africa (30 percent), and in the French overseas territories (50 percent). It focuses on education and supportive technical assistance (primarily teachers), which together comprise over 90 percent of the program. Remaining assistance is scattered among public utilities, health, and other sectors. There is only modest French attention to private sector development, which is found primarily at three organizations, PROPARCO, CEPIA, and ANVAR, and which emphasizes the promotion of French foreign investment and technology transfer. There is no policy dialogue on private sector development.

PROPARCO (Societe de Promotion et de Participation pour la Cooperation Economique) was created in 1977 as the investment promotion arm of the Caisse Centrale de Cooperation Economique, the French development bank generally responsible for the capital loan program of the French aid effort. PROPARCO facilitates French private investment in industrial development in the 37 countries of Sub-Saharan Africa and in the overseas territories. PROPARCO, which has a professional staff of seven, assists at each major stage of the project development process, providing information for the prefeasibility effort; offering reimbursable financing for feasibility studies; undertaking financial, economic, and technical evaluations of proposed projects; taking a minority equity position in a project (up to 10 percent); assisting in the arranging of debt financing for a project, especially from the Caisse Centrale; and, as shareholder and director, monitoring closely the management and operation of companies which it promotes.

PROPARCO in essence plays the role of catalyst in the investment process. It identifies projects through the staff personnel of the Caisse Centrale overseas, brings French investors, particularly SME, into contact with opportunities offered by both public and private African enterprises and provides through equity participation the protective "umbrella" many French firms require to consider risky ventures abroad. The program is modest, however, having invested only a little over $400,000 in seven projects in 1983. In total, PROPARCO holds a portfolio of 25 companies, involving some $2 million in equity shareholdings.

CEPIA (the Centre Francais de Promotion Industrialle en Afrique), created in 1972, has as its principal objective the identification of industrial projects of possible investment interest to French enterprises, particularly small and medium size, in association with LDC partners, both public and private. The CEPIA Board is composed of representatives of relevant government ministries, industrial federations, chambers of commerce and industry, banks, and both public and private enterprises. Members include interested provinces, chambers of commerce, federations, and enterprises. CEPIA is essentially the mechanism established by French industry to seek out and facilitate industrial investment opportunities in a zone of traditional French economic involvement. Its program is much less diverse geographically than PROPARCO, focusing primarily on Tunisia, Morocco, Senegal, Ivory Coast, Togo, Cameroon, Gabon, Mali, and Kenya. CEPIA itself provides no financing for projects.

In association with relevant authorities in the interested LDC countries, CEPIA identifies projects, locates partners, determines project feasibility, presents project proposals to interested banks and local authorities, and monitors the development of the project until it is successfully launched. So far CEPIA has helped to establish more than 250 French/African industrial enterprises, most particularly in Tunisia. These enterprises represent a total investment of more than $175 million, and have generated nearly 19,000 jobs in Africa. Projects are concentrated in agroindustry, woodworking, construction, leather, textiles, mechanics, and electronics.

Currently, CEPIA has an agreement with the Tunisian Investment Promotion Agency under which a Tunisian citizen works in the CEPIA office in Paris.

The third French organization is ANVAR (Agence Nationale pour la Valorisation de la Recherche), a public enterprise created and controlled by the Ministry of Research and Technology but which operates on an independent financial basis. Its stated mission is "the development of French industry by technological means." This is to be accomplished by developing new technologies and modernizing industry. Most of ANVAR's program is oriented toward French domestic industry.

ANVAR has a staff of 450 professionals, 250 at headquarters in Paris, of whom only two are specifically responsible for ANVAR's interests in the LDCs. ANVAR also operates through 22 branch offices throughout metropolitan France.

ANVAR has recently created a special program to encourage the development of new technologies for projects in the developing countries. The program is open both to French enterprises and research laboratories.

For projects to develop new products or processes which are specifically aimed at the LDCs and/or developed in cooperation with an identified LDC partner, ANVAR can provide a grant of 50 percent of the cost of the research. For projects aiming simply at the introduction into the LDCs, in cooperation with an identified LDC partner, of established new products or processes, ANVAR offers a grant of up to 75 percent of the project. So far the ANVAR/LDC program has supported about 20 specific projects for the LDCs. Although many of these involve private sector enterprises, the ANVAR program carries no special brief for private versus public sector. Its current annual budget is about $500,000.

In addition to these programs, the Caisse Centrale provides substantial support to a wide range of DFCs and other development agencies, primarily in the overseas territories. To a considerable extent this effort focuses on SMEs. The French also have a significant mixed credits program to subsidize French exports. The Treasury negotiates a 20-30 year loan at 3 percent interest and the money is then available to the LDC for mixing with export supplier credits. The French also have a program (COFACE) to insure businesses against political risk in exports (not, however, in investments).

2.2 Federal Republic of Germany

The West German assistance program is planned and directed by the Ministry of Economic Cooperation (BMZ). All programs, however, are implemented through other agencies and organizations. Foremost among these are the German Agency for Technical Cooperation (GTZ) for the provision of technical assistance, the German Finance Corporation (DEG) for private development finance, and the Reconstruction Credit Bank (KFW) for the general capital grant and loan program and other special services. Like the French program, the German aid effort comprises a large (one-third) technical assistance component. Sectoral emphases include infrastructure, agriculture and renewable natural resources, industry, education, and science.

Although the German program has always had a substantial orientation toward the involvement of both developed country and LDC private sectors in the development process, the current Government has expanded this emphasis, focusing particularly on the need to increase the participation of West German SMEs in the LDC development process. Nonetheless, the Goverment does not actively pursue a policy dialogue with recipient countries on the relative merits of the private versus public sector approach, leaving this matter primarily to international attention.

The principal West German institution involved in private sector activity in the LDCs is the DEG which was founded in 1962 with the BMZ as its sole shareholder. The DEG fosters direct investment by German or other European Economic Community (EEC) companies in joint venture projects in the LDCs. Established with an authorized capital of about $300 million, the DEG operates on a commercial basis with two-thirds of the Board of Directors coming from the private sector. It has no sectoral prior-ities. Much like the IFC, the DEG offers venture capital and long-term credit to new or expanding companies meeting certain developmental criteria. It also cofinances about 50 DFCs in the developing countries at a level historically absorbing about 20 percent of its annual budget. All projects must involve a German or EEC partner. Local partners are expected to be private sector companies, but of necessity are frequently from the public sec-tor. The DEG equity participation in industrial projects must always be less than that of the German partner. Equity in such projects is generally held for about 12 years and then sold, although disposing of share capital has often been difficult. In particular, the DEG has the following functions:

-- Makes equity investments and/or loans with equity features

-- Promotes the identification of projects and the brokering of appropriate partners

-- Advises on the planning and execution of projects

-- Assists in arranging additional financial facilities

-- Provides investment data on selected high-potential LDCs

Since its establishment, the DEG has assisted in the financing of about 250 enterprises in more than 70 countries. At the end of 1983, DEG had accumulated commitments of some $300 million, of which 49.5 percent was in equity shareholdings, 44.2 percent in loans and credits, and 6.3 percent in guaranties. In 1983 the DEG undertook 53 commitments in 31 countries totaling some $30 million.

Another largely private sector-oriented program is the Business Cooperation (BC) Program. This program, now run jointly by the GTZ and the DEG, develops trade, technology transfer, and investment linkages between LDCs and German, particularly SME, companies. The essence of the BC program is the BC consulting team, which typically consists of a consultant in the particular LDC, backstopped by a counterpart consultant based in West Germany. The German advisor abroad establishes a BC promotion office within the ministry, development bank, or other local agency most responsible for promoting trade and investment with foreign countries. The backstopping consultant is based at the headquarters of the particular German consulting firm responsible for the BC program in that LDC.

As a general rule, requests for know-how, joint venture partners, licensing arrangements, and leads to investment project possibilities are identified by the BC promotion office in the LDC. The backstopping consultant in West Germany, upon notification, then pursues the linkages. Similarly, German companies may contact the BC country office in West Germany with requests for linkages to potential partners or agents in the LDC. The German office informs the BC office in the LDC, and the local linkage is developed.

Although the BC program is not inexpensive ($350,000 per country, including both the in-country BC office costs and the costs of backstopping within West Germany), the program claims over 200 successful interventions during the 5 to 6 years of its existence. Currently, there are 30 BC program offices in 22 partner countries.

Another program of recent creation (February 1, 1983) is the In-Plant Training Program in Developing Countries. The object of the program is to expand formal in-plant training in the LDCs and in particular to support the training activities of West German enterprises active in the LDCs. In principle, any in-plant training program in an LDC intended to meet medium-term or long-term requirements for skilled personnel in one or more enterprises may receive support. This will include programs involving West German firms primarily, but in selected cases also those of local LDC companies and LDC training centers. The support takes the form of subsidies of up to $125 per trainee per month.

The German assistance program also includes an organized effort to assist LDC exports to West Germany and other EEC countries. This effort, managed by the GTZ, focuses on exploiting the opportunities provided by trade fairs. Small subsidies are provided (stall rent) to assist LDC exporters to attend these fairs and to display their wares. GTZ also helps by sending experts to the LDCs to prepare products for the fairs, for example, by identifying samples suitable to meet EEC quality standards. At the fairs GTZ aids the LDC exporter in making contact with appropriate German and other EEC importers.

A low-interest loan program to assist West German firms introducing new technologies in the LDCs by financing up to 50 percent of the firm's participation was set up in 1981 by the KFW but has so far not worked out very well and will likely be eliminated in the near future. Its failure may have been the result of overly restrictive conditions: the project must be a joint venture with an LDC company; it must produce for the local market; it must solve a specific LDC problem; and it must be introduced to the LDC for the first time.

Other programs include the reimbursable financing of preinvestment and market studies, capital investment guaranties, insurance against political risk, export credit, insurance and guaranties, and a senior expert service similar to the IESC in the United States. This latter was set up in 1983 and during the year undertook 22 voluntary short-term advisory assignments. The KFW administers the German Government's mixed credit program. Although this program may not be as large as others, its use is reportedly on the increase.

2.3 United Kingdom

The British development assistance program focuses primarily on Commonwealth countries. It works broadly in four sectors: renewable natural resources, economic and social infrastructure, education, and health and population. Except insofar as its assistance to infrastructure and its support of IMF and World Bank policy reforms and adjustment programs promote private sector approaches, British interest in private enterprise development is focused on the work of the Commonwealth Development Corporation (CDC). There is no active policy dialogue on private sector development with the LDCs.

Nonetheless, the British have recently increased their attention to the issue. In June 1983 the Overseas Development Administration (ODA) and the Confederation of Industry (CBI) organized a conference on "Aid, Private Enterprise and Development." The CBI arranged a more specialized follow-up conference in November 1983 titled "Investing in Developing Countries." Also in November the ODA appointed a Commercial Liaison Officer to act as a central point of information to the business community on the ODA aid program.

The CDC, established in 1948, is dependent largely on funds advanced by (and which must be repaid to) the Treasury. It currently has the authority to draw up to $800 million. CDC operates along broadly commercial lines, investing in projects which not only help to develop the resources of an LDC but also yield a reasonable return. The corporation cannot therefore undertake projects of a social nature such as schools and hospitals. Nonetheless preference is given to projects offering high-priority development results; that is, projects which generate or save foreign exchange, encourage savings and assist credit formation, create local job opportunities, foster management capability and spread technical knowledge, and contribute to greater income equality inside the developing country.

The CDC provides medium- to long-term development money in the form of loans, equity capital, and loans with equity features. Generally, CDC participation is 10 percent at a minimum and 30 percent at a maximum. Officially, CDC has no preference for private versus public sector involvement. It also does not require a project to include a British private partner; only 20-25 percent of their projects involve U.K. investors. This issue is determined by the circumstances, as, for example, in Asia where most of their projects are now initiated by the private sector. The only real criterion is whether the project is good for the country. In point of fact, however, the bulk of CDC projects are in the LDC public sector.

The staff consists of some 100 professionals experienced in managing enterprises, and CDC consequently often becomes involved directly in project management. They also have branch offices abroad which identify project possibilities and oversee ongoing projects.

In 1983 CDC made commitments of about $125 million to 29 new projects and supplementary commitments, of which seven were in association with British companies. As of the end of 1983 some 33 percent of CDC commitments were to infrastructure, 52 percent to primary production and processing, 6.3 percent to DFCs, 8 percent to industry, and 0.7 percent to hotels and tourism.

Other ODA programs include financing of feasibility studies up to 50 percent on a reimbursable basis; the United Kingdom Trade Agency which assists LDCs to export to the United Kingdom; a political risk insurance program run by the Export Credit Guarantee Department of the Ministry of Trade and Industry; and the British Executive Service Overseas (BESO), an IESC-like operation which assigned 127 experienced British executives on short-term projects in 36 LDCs on a voluntary basis in 1983. The AID-Trade program is the substantial British mixed-credits facility, which is viewed as a necessary retaliation to competitors' programs, and is limited to projects classified as "developmental" by the ODA.

2.4 Canada

The Canadian assistance program has become increasingly active in efforts to involve Canadian private enterprise in development activities. It eschews, however, an activist policy dialogue with recipient countries on the subject of private sector development. The focus of the Canadian effort is the Industrial Cooperation Program (INC), an umbrella program established in 1979 that offers support to small- and medium-scale Canadian companies seeking trade, technology transfer, and investment opportunities in the LDCs and for LDCs seeking Canadian private sector participation in their economic development.

For Canadian companies wishing to investigate industrial cooperation opportunities in developing countries the INC provides the following:

-- Funding for travel, profitability and risk analyses, product/technology testing

-- Funding for project preparation studies as a lead-in to large capital projects

-- Funding for demonstration/test projects as a lead-in to technology transfer

-- Leads and information on opportunities and on local conditions and business practice

-- Assistance in locating qualified Canadians to work abroad

-- Specialized training of local employees

-- Professional services to cope with special situations, such as complex tax or legal problems

-- Investment missions to developing countries

For developing countries seeking Canadian private sector participation in their economic development, the INC offers these services:

-- Investment-seeking missions to Canada

-- Information on Canadian technology and expertise

-- Trade facilitation

-- Business training in Canadian and local business and manufacturing organizations

-- Public sector institution building in cooperation with Canadian counterpart institutions

-- Technical assistance in businesses requiring short-term experts

-- Assistance for the use of Canadian consultants or experts to assist in delineating industrial development priorities, promoting and managing exports, and providing direct, continuing expert advice to all segments of the economy, private and public

The objective of these many activities is mutually profitable business relationships between Canadian companies and their developing country counterparts, for example:

-- Joint ventures

-- Direct investments

-- Management contracts

-- Licensing agreements

-- Co-production arrangements

-- Technical cooperation

-- Technology transfer

-- Project preparation studies

-- Information development and dissemination

INC's mandate is to link SMEs in Canada with SMEs in the LDCs. However, experience shows that often neither type of SME has the institutional capability to undertake joint venture projects.

INC, with a budget of around $25 million, represents only 1.5 percent of the total Canadian International Development Agency (CIDA) budget. It receives about 1,200 assistance requests a year and approves about half. Most of CIDA's private sector focus is related to linking Canadian private resources to LDC requirements.

Growing interest in promoting this linkage is evidenced by the creation in mid-1984 of a new Business Cooperation Policy branch in CIDA. This department will have two basic functions: (1) policy development and (2) assistance to Canadian companies through information about opportunities and financing. Business Cooperation will be responsible both for INC and the proposed aid-trade or mixed-credits fund. This latter, if implemented as proposed, will use 50 percent of prospective increases in the volume of Canadian ODA up to a targeted 0.7 percent of GNP to help Canadian firms to provide additional goods and services in support of Third World development.

CIDA also finances DFCs and the Canadian Executive Services Overseas (CESO) program, the Canadian equivalent of the IESC.

3. OTHER U.S. AGENCIES

3.1 Overseas Private Investment Corporation (OPIC)

OPIC was created by the Foreign Assistance Act of 1969 to mobilize and facilitate the flow of private U.S. capital and skills to friendly countries and areas of the developing world. OPIC operates two main programs: (1) it provides insurance for U.S. private investments against certain political risks, and finances projects sponsored by eligible U.S. investors through direct loans and loan guaranties; and (2) it undertakes activities to promote and encourage U.S. investment abroad. OPIC is self-sustaining, having earned a net income of some $83 million in 1983.

OPIC insured through its political risk insurance program $3.9 billion in investments in some 100 projects in 1983. OPIC's Direct Investment Fund (DIF) provides direct loans ranging from $50,000 to $4 million exclusively to projects sponsored by U.S. small businesses. For firms lacking overseas experience, OPIC may represent the only available source of financing for new ventures abroad. In 1983 DIF provided direct loans and loan guaranty commitments of $110 million and local currency loans of $7.3 million for 19 projects.

OPIC preinvestment and investment encouragement programs were also very active in 1983.

Investment Missions -- Since 1975 OPIC has been organizing missions to LDCs to acquaint U.S. investors with business opportunities. In 1983 OPIC organized six investment missions in which more than 150 senior-level executives from nearly 130 U.S. companies participated. A total of more than 100 potential investment projects were identified. AID cosponsored three of these six missions.

Feasibility Study Program -- To assist companies with limited resources and international experience to explore investment opportunities in the LDCs, OPIC provides financial support for investment feasibility studies. OPIC supported 33 such studies in 18 developing countries in 1983 at a cost of $930,000.

Opportunity Bank -- This service was launched in 1983 to foster the exchange of information between potential U.S. investors and foreign project sponsors. The Bank's computerized data base contains profiles of foreign projects seeking U.S. investment and profiles of U.S. companies interested in undertaking ventures abroad. There are currently more than 1,000 foreign project profiles and 4,000 U.S. companies listed.

Investor Information Service -- This service is a publications clearinghouse that provides access, in packaged form, to a variety of business and investment information provided by U.S. Government agencies and international organizations. Information kits are presently available for 100 developing countries as well as 10 major market regions.

3.2 Export-Import Bank

The Export-Import Bank of the United States (Eximbank), established in 1934, is the U.S. Government agency that offers loan, guaranty, and insurance programs to supplement and facilitate the private sector financing of U.S. export sales. It is not a development agency, but rather is interested in assisting the sales of U.S. goods and services abroad. Moreover, Eximbank does not concern itself over the issue of whether the foreign purchaser is in the private or public sector or whether a local company is helped "developmentally" by an Eximbank transaction. Nonetheless, the Eximbank's portfolio will soon be 90 percent in LDC transactions, and it must therefore be concerned about those countries' economic condition.

Eximbank enables American exporters to compete for multimillion dollar export contracts for heavy capital goods exports and major project construction by offering long-term direct loans to foreign purchasers and financial guaranties providing repayment protection for commercial lenders. In FY 1983, the Eximbank authorized 21 direct loans totaling $684.7 million and 32 financial guarantees totaling $1.2 billion.

The Eximbank also offers assistance on short- to medium-term transactions. An export credit insurance program insures exporters extending "supplier's credits" to foreign customers and to banks acting as exporters of record. The export credit program accounted for $6.8 billion or 72 percent of the Bank's authorizations in 1983. Demand for the Eximbank's medium-term commercial bank guaranties was also strong in 1983, as 217 medium-term guaranties were extended totaling $528.7 million.

The Eximbank offers a special medium-term credit program of fixed-interest rate support for export sales which the supplier can demonstrate are facing subsidized, officially supported export credit competition from abroad. The Eximbank loans its funds directly to the U.S. bank financing the export sale. This program is the major available U.S. facility for providing mixed credits.

Special programs are offered to small business in the United States. The small business credit program operates like the medium-term credit program but without the required demonstration of a subsidized competitive offer. The working capital guaranty program helps small companies meet their critical needs for pre-export financing.

3.3 U.S. Trade and Development Program (TDP)

TDP was established in 1980 as a mechanism by which simultaneously to facilitate Third World development, particularly in the middle- and upper-income LDCs, and to increase U.S. exports. Its 1980 budget was $16 million. TDP offers a range of project planning services to help LDC governments explore and formulate major capital-intensive development projects. The program was initiated largely to offset the actions of competitor governments, which were offering attractive preproject incentives to LDC governments as a means of opening business opportunities for their firms. For example, a competitor government might offer to fund a project feasibility study if one of its firms is selected to do the study. The expectation is that this approach will facilitate the introduction of that country's technology and thus open the door to the sale of the capital goods and equipment required to implement the project.

Project planning services financed by TDP include the following:

1. Definitional studies -- to assess project potential and recommend whether to pursue further technical assessments

2. Prefeasibility studies -- to assess whether a project sould be undertaken and on what basis

3. Feasibility studies -- to determine the technical, economic and financial feasibility of projects and to provide data for deciding how to proceed with project implementation

4. Technology symposia -- in the host country aimed at leading to prefeasibility studies by U.S. companies

5. Technology orientation missions -- to the United States to permit key host country decisionmakers to review U.S. technology

TDP also assists U.S. companies in exploring investment opportunities abroad. Like OPIC, it cofinances, on a reimbursable basis, feasibility studies by U.S. firms of projects in which the U.S. firm intends an equity participation.

TDP has no special orientation toward private sector development. By the very nature of its focus on large, capital development projects, TDP projects tend to be in the public sector.

APPENDIX B

SYNTHESIS OF AID BUREAU FOR PROGRAM AND POLICY COORDINATION SPECIAL STUDIES ON PRIVATE SECTOR DEVELOPMENT

1. INTRODUCTION

Since the late 1970s, the international community has witnessed a reorientation in development strategies, away from the government-directed development philosophy of the late 1960s and early 1970s and toward a greater reliance on market systems to achieve development objectives. This reorientation is evident in the emphasis being given by all major donor organizations, both bilateral and multilateral, to the role of the private sector in the development process. In the United States it has been manifested in the Agency for International Development's (AID) Private Sector Initiative, first enunciated in early 1982 by the AID Administrator, which attempts to strike a balance between aid to the public and private sectors in AID's assistance program to the less developed countries.

As part of this initiative, the Bureau for Policy and Program Coordination's Office of Evaluation (PPC/E) undertook a series of special studies from late 1983 to mid-1984 to evaluate AID's historical experience with private sector assistance. The series was designed to distill from this experience any lessons that might serve as guidelines in the formulation of a new private sector strategy and program for AID. Five studies, dealing with different segments of the private sector, different economic sectors, and different delivery mechanisms for project assistance, were chosen for this special study series. Most of these projects were begun in the 1960s and have therefore been in existence long enough to produce verifiable results. All five are considered to be success stories by both the recipient countries and AID, and as such clearly merit close scrutiny.

The five studies analyze the growth of the seed industry of Thailand, management education in Tunisia, a private development corporation in the Philippines, small-scale agricultural machinery manufacture in Indonesia, and two industrial development finance companies, one public and one private, in Ecuador. Each study examines the project background and rationale, focusing on the key constraints to development of the particular target industry or sector; describes the AID project assistance strategy and implementation; evaluates the project's effectiveness in meeting its objectives and its impacts, both planned and unexpected; and finally, draws conclusions or lessons learned from the successes and failures of the project that may be replicable in future projects.

Much of the value of these studies lies in their comprehensiveness; not only do they evaluate the impact of a specific project intervention, but they also analyze the process of private sector development in each of their respective areas. Taken together they provide an important record of some of the principal constraints to private enterprise development in LDCs, suggest an appropriate role for the donors in relieving these constraints, and identify the particular delivery mechanisms best suited to each type of project or program assistance.

Although this section attempts to synthesize the lessons contained in the special studies, it is not meant to be a substitute for them. Rather, it should serve as an introduction to the special study series, which is expected to be available in the AID evaluation publication series in the near future.

2. CONSTRAINTS TO PRIVATE SECTOR DEVELOPMENT

Private sector development is constrained by a number of factors that either limit profitable opportunities or reduce the ability of firms to respond to such opportunities. As discussed in the body of this report, these constraints can arise at the level of the economy, in the capital markets, or at the level of the firm. Each of the special studies documents a certain set of conditions that constrain the development of the targeted institution or industry.

At the level of the economy, the principal constraints identified are government policy and regulatory action, general economic conditions, and limited infrastructure. Government policies were identified as a constraint in Ecuador, the Philippines, and Thailand. In the case of Ecuador, it was found that restric-tive Government monetary policies, the taxation of retained earn-ings, and overvalued exchange rates acted as a deterrent to in-dustrial investment. The Government responded with a series of incentives to promote industrial development and the establish-ment of an institutional framework, including two AID-financed industrial finance corporations: CFN, a public institution, and COFIEC, a private one. These institutions, although successful in fulfilling the demand of Ecuadorian industry for long-term financing, have nonetheless been hampered in their operations by their inability to mobilize domestic resources, a direct result of Government policies regarding interest rate ceilings and taxation.

In the Philippines an AID loan helped to create the Private Development Corporation of the Philippines (PDCP) in 1963. This institution, like CFN and COFIEC in Ecuador, has found lack of access to local currency to be a major constraint to its development. This problem stemmed from Government financial and monetary policies, and regulations which denied PDCP the authority to receive deposits, thereby severely limiting its access to domestic resources.

Government price policies in Thailand are one of several factors which have clearly made the production of rice seed unattractive to private enterprises. By maintaining price ceilings on the sale of rice seed, the Government has discouraged or preempted the entry of private firms into this area of activity.

General economic conditions are a second constraint to private sector development at the level of the economy. Although this was not cited specifically as a constraint in any of the Special Studies, the small size of the domestic market may have been a constraint to industrial development in both Ecuador and the Philippines.

The third major constraint at the level of the economy is the lack of productive infrastructure, which increases the cost of production or can make production unfeasible. Limited infrastructure was mentioned as a constraint to private industrial development in Thailand and Ecuador, particularly in rural areas.

Deficiencies in the capital market were identified as the major constraint to private sector development in both the Philippines and Ecuador. In both these countries the capital market was "incomplete," because of a lack of long-term credit. For example, only 12 percent of total bank credit was directed toward industry in Ecuador in 1959, and only 10 percent of that at terms of more than 1 year, for a total of only 1.2 percent of bank credit going to long-term financing for private sector industrial development. Coupled with the policy constraints mentioned above, this credit squeeze virtually halted industrial expansion. In both countries the problem was further compounded by the almost total absence of an equity market or equity resale market.

In Indonesia credit was relatively accessible to the fabricators of small-scale agricultural machinery, but not to the farmers who purchase this machinery. This problem indirectly affected the manufacturers and led to some innovative solutions, such as the provision of credit to farmers by the fabricators themselves.

The third type of constraint to private sector development arises at the level of the individual firm. This includes the shortage of managerial and technical skills, limited access to technology and information, and poorly developed markets for inputs and outputs. Lack of management skills was identified as a major constraint to private sector development in Tunisia, a middle-income country with only one university and no graduate-level training in business management skills. Graduates were in short supply for both employment in the productive sectors and university teaching. In Thailand the shortage of both managerial and technical skills created a major barrier to development of the private seed industry, which was forced to rely almost exclusively on technical innovations developed by employees of the Government seed centers.

Limited access to technology and information was a key constraint to the development of a local, small-scale agricultural machinery manufacturing industry in Indonesia. Small rural fabricators lacked both access to information about production technologies appropriate to the needs of their market, and commercial ties to potential sources of this information. In addition, these small manufacturers were hampered by a relatively undeveloped market for their output, which forced them to spend substantial time and money on marketing, thereby increasing costs.

As indicated, the process of private sector development can be constrained by different factors at different levels of the economy. Projects designed to relieve such constraints vary as to types of project assistance provided and the specific project delivery mechanisms used. Often a combination of several types of assistance is required to fully address the range of constraints. The following section describes the various approaches used in the five projects under review.

3. TYPES OF PROJECT ASSISTANCE AND DELIVERY MECHANISMS

The main types of project assistance used by AID include capitalization, technical assistance and technology transfer, training, policy dialogue, promotion services (both investment and export), and economic support (through commodity import programs, balance of payments support, and so on). Assistance can be channeled through different delivery mechanisms, such as central governments or government agencies, parastatals, nonprofit research organizations, and private for-profit enterprises. Here also, the PPC Special Studies provide valuable case studies of the relative advantages and disadvantages encountered in the use of these alternative strategies for project implementation.

Financing of lending operations was the main type of project assistance used in both the Philippines and Ecuador, where constraints in the capital markets were found to be the major impediment to private sector development. However, different delivery mechanisms were used in each case. In the Philippines an AID loan was made in 1963 to assist in the establishment of a private intermediate financial institution (PDCP). The PDCP is prominent today as the major institution in the country specializing in long-term development lending. Clearly one of the reasons for the success of PDCP is that it fulfilled a previously neglected segment of the financial market, that of long-term lending. A strong internal training division and active management support for training were also important factors in PDCP's success.

The case of Ecuador is particularly significant as a comparative study of the effects of lending to private versus public institutions. AID made two loans in Ecuador in the mid-1960s to establish two industrial finance corporations, one private (COFIEC) and one public (CFN). Both serve as the principal sources of long-term finance for industrial investment, through lending with up to 12-year terms and through direct equity investments in industrial enterprises. Approximately 46 percent of new industrial jobs during the period 1961 to 1979 can be attributed to these two banks. Both have functioned effectively in the allocation of long-term financial resources for development. However, a comparative analysis shows that there are significant differences between them. CFN has received about 40 percent of its domestic resources from capital contributions of the Government. As a public entity, it has been required to enter into Government projects with little or no return on investment, which has lessened its efficiency. It also has proved more conservative in its lending, using more rigid analytical procedures, which was often quoted by borrowers as a drawback. COFIEC, on the other hand, received the majority of its resources from private sources and has proved to be a solid investment for its owners. It has maintained a lower relative cost of operation, as well as a lower quality portfolio, and is seen as more of a risk taker. In terms of the sectoral breakdown of their lending, CFN concentrated in two sectors only, with 91 percent of its lending in 1982 going to manufacturing, while COFIEC has diversified into six sectors, with 58 percent of its lending in 1982 going to manufacturing.

The Special Study takes no clear position for or against the use of private or public DFIs. It states that in Ecuador, both public and private banks have functioned effectively in the allocation of long-term resources for development and have contributed to the growth of employment and investment in Ecuador. As mentioned earlier, Government policies (interest rates, taxation) have limited the ability of both institutions to mobilize domestic savings, and both are still dependent on external borrowing. In fact, the study concludes that there may be benefits from the creation of both public and private development finance companies (DFCs), including more rapid growth in the volume of industrial credit, complementarity in credit lines, and a wider choice of options for borrowers which has created a degree of competition between the two institutions. A possible advantage to the use of a private DFC for implementing donor assistance may be that it can take more risks in its lending. Moreover, its lending pattern is not distorted by being obliged to enter into government-supported projects that offer no investment return.

Technical assistance and technology transfer were the major types of assistance used in the Thai seed projects and the Indonesia industrial extension project. In both cases the projects were implemented through the government: in Thailand, through the provision of technical assistance and training to the Government seed centers, and in Indonesia through the Ministry of Agriculture's extension agency and the International Rice Research Institute (IRRI). However, in both cases public sector delivery was appropriate. In Indonesia, the AID project supported the industrial extension of agricultural machinery, designed by IRRI, through the Government extension agency because this was the only existing network operating at the village level in all the chosen test areas. The role played by the Government extension agents was mainly one of demonstrating locally made equipment to the farmers in order to stimulate demand for local, privately manufactured machinery. This provided valuable impetus to stimulating private enterprise. The project objective, promoting private enterprises by institutionalizing the process of technology transfer from government to the private sector, has been achieved.

The Thai seed projects, interestingly, were not originally designed to promote the private seed industry. They were intended mainly to support research and development of improved rice and other seed varieties by the Government seed centers, which were to perform a market testing and development function. The Government has succeeded in its demonstration role and has in fact attracted private investment into the production, processing, and distribution of certain improved seed varieties, notably corn and sorghum. Another stimulus to the development of a private seed industry in Thailand came from the linkage of existing Thai agribusinesses with experienced international companies active in the seed area. This trend was explicitly encouraged by the Government through provision of investment incentives to both domestic and foreign firms entering the seed industry. Private enterprises have, however, been discouraged from entering into rice seed production by Government price controls which render the industry unprofitable for private firms. The study recognizes the importance of this disincentive to private sector participation in rice production and urges the Government to gradually increase the price of rice seed.

In Tunisia, where the lack of management skills posed a key constraint to private sector development, the AID project focused on providing training and technical assistance in the creation of a graduate-level business school, the Institut Sup/rieur de Gestion (ISG), in 1969. This project was funded by a grant to the Tunisian Government, which established the ISG within the University of Tunis, a public institution. Tunisian faculty were sent for training to U.S. universities, and a U.S. university assisted in the implementation of the project in Tunisia. Recent graduates of the ISG are evenly distributed between the public and private sectors and are particularly in demand by large private enterprises.

4. AID'S ROLE: LESSONS LEARNED

Not only do these special studies provide lessons as to the types of assistance and delivery mechanisms most suited to stimulating the growth and development of the private sector in LDCs, but they also contain valuable lessons as to the most appropriate and effective role for AID in this process. The key conclusions regarding AID's role can be summarized as follows:

1. Greater attention to overall sector analysis should be a prerequisite to AID assistance to any sector. A detailed sector analysis of constraints, weaknesses, and opportunities for reform is critical to the design of appropriate and successful project interventions. In the Philippines, for example, a complete sector appraisal prior to project design may have identified some of the constraints inherent in the policy framework which have hampered PDCP's growth for 20 years.

2. It is both appropriate and effective for AID to pioneer the use of innovative approaches to development in various economic sectors. For example, in Ecuador, AID's provision of seed capital to two development finance institutions in the early

1960s contributed to the establishment of clearly viable institutions and successfully attracted support from other sources. Likewise in the Philippines, AID's innovative use of local currency resources to finance the establishment of PDCP was a major element in the success of the project.

3. Intermediate financial institutions (IFIs) are an appropriate and viable delivery mechanism for credit on-lending to individual private enterprises. By wholesaling credit through an IFI, AID assistance has a far greater impact at less administrative cost than it could derive from a direct loan program. As stated in the Philippine study: "PDCP illustrates well the enormous return AID achieved through an initial investment in creating PDCP. PDCP managed the placement of the AID funds far better than AID could have due to PDCP's closer proximity to the market and due to its far superior professional staff capability."

Loans to IFIs should be supplemented by technical assistance to improve the costs and efficiency of these institutions. Management information systems and training in project evaluation and monitoring offer particularly promising areas for assistance to IFIs. In addition, AID should engage in policy dialogue regarding implementation to enhance the effectiveness of its support to IFIs. In the case of both Ecuador and the Philippines, it was found that the development impact of the two IFIs could have been enhanced if AID had maintained a policy dialogue regarding implementation on a more continuous basis. Obviously this is easier said than done. However, some form of policy dialogue pursued in the context of project implementation may be more readily accepted by LDC governments than overall policy reform attempts, if the scope of policies addressed is limited to those affecting the specific project.

4. AID's focus on assisting small- and medium-scale enterprises is appropriate. The SME segment typically generates a major proportion of employment and income in LDCs (for example, 60 percent of the total labor force in Ecuador is employed in SMEs), and has greater backward and forward linkages to the rest of the economy than most other segments. However, as mentioned above, AID's assistance to this segment can be most effectively channeled through intermediary institutions such as development finance corporations or private voluntary organizations because of their greater knowledge of the local economy and its needs, and also because of the high costs associated with the provision of direct assistance to SMEs.

5. AID should seek to focus its assistance in areas in which it has a comparative advantage relative to other donors. The provision of local currency resources may be a potential "market niche" for AID because of the substantial amounts of local currency being generated by PL 480 and commodity import programs. As stated in the Philippines study: "PDCP would not have been formed without AID's initial contribution of quasi-equity -- the peso contribution met a need of PDCP not available from IFC or IBRD and highlights a market niche for AID

participation that we believe has wide application in countries where substantial local currency resources are currently being generated through CIP programs or PL 480 generations or both.... A redirection of local currency by AID from public sector investments to private sector opportunities deserves an early in-depth review by AID."

6. Technology transfer is both time and labor intensive. As shown in Indonesia, very intensive efforts are required to generate the demand for new technologies, in this case for both the manufacture and use of new agricultural machinery. However, technology transfer can have important downstream and multiplier effects which enhance its value. For example the industrial extension of small-scale agricultural machinery in Indonesia has led to greater land utilization.

7. Often the lack of a mechanism for ongoing technology diffusion is a more important constraint to development than the limited use of specific technologies themselves. Great care must be exercised to ensure that the process of technology transfer is institutionalized. Again, the Indonesian industrial extension project illustrates well the need to institutionalize the process of transferring technology from the public to the private sectors.

8. Institution building, research, and market development require a long-term involvement. The point may seem simplistic, yet it is often overlooked in project design. For example, in Tunisia, AID's assistance to ISG was ended after 5 years, which was premature and consequently led to some problems in the further growth of ISG. Thailand's seed industry is another example of the need for a lengthy commitment to development.

9. Training of professional staff is a valuable contribution to economic development. This conclusion was stressed in several of the Special Studies. A skilled personnel base, whether in private or public institutions, will ultimately support the expansion of the economy. Trained professionals were critical to the success of the private seed industry in Thailand, and to the development of the private sector in Tunisia.

APPENDIX C

DATA BASE OF AID PRIVATE SECTOR PROJECTS, FY 1981 to FY 19841

Page

Index to Private Sector Data Base

{1}Note: See the data base coding sheet (pp. C-3 to C-6) for an explanation of data base column headings.

CODING SHEET FOR USE IN PRIVATE SECTOR REVIEW DATA BASE

DATE ----------------- CODER-----------------------

Instructions: circle appropriate code based on information in
project description

ITEM FIELD ENTRY CODE

1. Project name text (enter text)

----

2. Project number number (enter number) --------
(for\non-project, enter zeros)

3. Country text (enter country)

----

4. (variable later omitted)

5. Start year Fiscal Year (enter #, eg. 81) --

6. End year Fiscal Year " --

7. Region
Africa AF
Asia AS
Latin Amer. LA
Near East NE
S&T, PRE, etc. WW

FUNDING

8. AID funding total AID $ (enter $ million) -----

9. Other donors
yes Y
no N

10. Host govt
yes Y
no N

11. Other US Govt
yes Y
no N

12. Commercial banks
yes Y
no N

13. Equity investors
yes Y
no N

TYPE OF ASSISTANCE (select one main and maximum of two yeses)

14. Direct investment
main M
yes Y

no N

15. Financing main M
yes Y
no N

16. Instit. devt. main M
yes Y
no N

17. Training main M
yes Y
no N

18. Promotion services main M
yes Y
no N

19. Policy reform main M
yes Y
no N

20. Tech. devt. or main M
transfer yes Y
no N

21. CIP or import main M
finance yes Y
no N

SECTOR AND PROJECT INVOLVEMENT

22. Main Sector Ag. production AG
Agribusiness/ AB
Inputs/
Processing
Manufacturing/ IN
Industry
Financial/ FI
Banking
Marketing/ MK
Commerce
Health HE
Housing HO
Education ED
Economic Supp./
BOP ES
Multisectoral MS
Unknown UN

23. Second sector Ag./production AG
Agribusiness/ AB
Inputs/
Processing
Manufacturing IN
Industry

	Financial/ Banking	FI
	Marketing/ Commerce	MK
	Health	HE
	Housing	HO
	Education	ED
	Multisectoral	MS
	Economic Supp./ BOP	ES
	Unknown	UN

24. Target group	Small/medium scale ent.	SM
	Unrestricted	OP
	Unknown	UN

25. Project delivery	Central govt.	GO
	Parastatal	PR
	Private	PS
	Mixed	MX
	Unknown	UN

26. PVO involvement	Yes	Y
	No	N

27. Project status	Planned	1
	Active/ Completed	(blank)

Guidelines Followed in Coding Projects for
AID Private Sector Review Data Base

Item	Field	Entry	Usage
Funding:			
9.	Other donors	yes	when clearly specified that other donors are providing funding in project abstract
		no	when not specified in project abstract
10.	Host government	yes	when clearly specified that host government is providing funding (not only assisting in implementation)
		no	when not specified that host government is actually providing funding

11. Other US Government	yes	when clearly specified that another branch of the US Government is providing actual funding
	no	when not specified in the project abstract
12. Commercial banks	yes	only when specified
	no	when not specified
13. Equity investors	yes	only when specified
	no	when not specified

Content of data bases missing.

AID PRIVATE SECTOR PROJECT EVALUATIONS

BY SECTOR AND PROGRAMMING AREAS

Table not available; please order Document Number PN AAL049 to view table in paper or microfiche form.

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